

NORTH CAROLINA

COMPREHENSIVE ANNUAL FINANCIAL REPORT

FOR THE FISCAL YEAR
ENDED JUNE 30, 2006



MICHAEL F. EASLEY
GOVERNOR

ROBERT L. POWELL
STATE CONTROLLER

Prepared by Statewide Accounting Division
Office of the State Controller

<http://www.ncosc.net>

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Special appreciation is given to the chief fiscal officers and the dedicated accounting personnel throughout the State. Their efforts to contribute accurate and timely financial data for their agencies, universities, community colleges, and institutions made this report possible.



MICHAEL F. EASLEY
Governor of North Carolina

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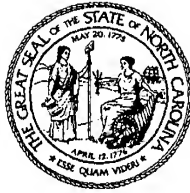
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INTRODUCTORY SECTION



State of North Carolina Office of the State Controller

Michael F. Easley, Governor

Robert L. Powell, State Controller

The Honorable Michael F. Easley, Governor
Members of the North Carolina General Assembly
Citizens of North Carolina

It is our pleasure to furnish you with the 2006 Comprehensive Annual Financial Report (CAFR) of the State of North Carolina in compliance with G.S. 143B-426.39. This report has been prepared by the Office of the State Controller. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the state government and this office. To the best of our knowledge and belief, this financial report is complete and reliable in all material respects. We believe all disclosures necessary to enable you to gain an understanding of the State's financial activities have been included.

Although the State budgets and manages its financial affairs on the cash basis of accounting, G.S. 143-20.1 requires the Office of the State Controller to prepare a Comprehensive Annual Financial Report (CAFR) in accordance with generally accepted accounting principles (GAAP) in the United States of America. Except for exhibits and notes clearly labeled otherwise, this CAFR has been prepared in accordance with GAAP.

For the convenience of users we have divided the CAFR into three major sections, described as follows:

- The **introductory section** includes this transmittal letter and the State's organization chart, including a listing of principal State officials.
- The **financial section** includes management discussion and analysis (MD&A), the basic financial statements (government-wide financial statements, fund financial statements, and notes), other required supplementary information, the combining and individual fund financial statements, and schedules.
- The **statistical section** includes selected financial, non-financial and demographic information, much of which is presented on a ten-year basis, as well as required supplementary information.

Management of the government is responsible for establishing and maintaining an internal control structure designed to ensure that the assets of the State are protected from loss, theft or misuse and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

In compliance with State statute, an annual financial audit of the State financial reporting entity is completed each year by the North Carolina Office of the State Auditor. The Auditor's examination was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the Auditor's opinion has been included in this report. In addition, the State coordinates the *Single Audit* effort of all federal funds through the State Auditor.

This letter of transmittal is intended to complement MD&A and should be read in conjunction with it. The MD&A provides an overview of the State's financial activities addressing both governmental and business-type activities reported in the government-wide financial statements. In addition, MD&A focuses on the State's major funds: the General Fund, the Highway Fund, the Highway Trust Fund, the Unemployment Compensation Fund, the EPA Revolving Loan Fund and the N.C. State Lottery Fund. The MD&A can be found immediately following the Independent Auditor's Report.

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Profile of the State of North Carolina

The Old North State, The Tar Heel State

North Carolina became the 12th state of the union in 1789. North Carolina is located on the Atlantic coast and is bordered by Georgia, South Carolina, Tennessee and Virginia. The State has a land area of approximately 50,000 square miles. The State's estimated population is 8.8 million, making it the 11th most populated state in the nation. Sixty percent of the population is found in urban areas, while forty percent is found in rural areas. The North Carolina coastline is 301 miles, the greatest distance east to west is 543 miles, and the greatest distance north to south is 188 miles. The State's elevation rises from sea level on the eastern coastline to 6,684 feet at Mount Mitchell in the Appalachian mountain range on our western border. There are 78,844 miles of roads, with Interstate 40 crossing North Carolina east to west, and Interstates 85 and 95 crossing the State north to south. North Carolina's capital and central state government administration is located in Raleigh, in the central piedmont. Charlotte, Raleigh, Greensboro, Durham, and Winston-Salem are North Carolina's largest cities and there are 100 counties.

Government

North Carolina's state government consists of an executive branch, a legislative branch, and a judicial branch. The executive branch is headed by the Governor. The Governor, Lieutenant Governor, and eight other statewide elected officers form the Council of State. The State Constitution provides that, "A Secretary of State, an Auditor, a Treasurer, a Superintendent of Public Instruction, an Attorney General, a Commissioner of Agriculture, a Commissioner of Labor, and a Commissioner of Insurance shall be elected by the qualified voters of the State...."

The legislative power of the State is vested in the General Assembly, which consists of a Senate and a House of Representatives. The Senate is composed of 50 Senators, elected on a biennial basis. The House of Representatives is composed of 120 Representatives, elected on a biennial basis.

The Courts of the Judicial Branch are split into three divisions, the Appellate Division, the Superior Court Division, and the District Court Division. Judges are elected on a non-partisan basis.

State Reporting Entity and Its Services

The State of North Carolina entity as reported in the CAFR includes all fund types of the departments, agencies, boards, commissions and authorities governed and legally controlled by the State's executive, legislative and judicial branches. In addition, the reporting entity includes legally separate component units for which the State is financially accountable. The component units are discretely presented in the government-wide financial statements. The State's discretely presented major component units are the University of North Carolina System; the State's community colleges; Golden LEAF, Inc., North Carolina Housing Finance Agency, and North Carolina State Education Assistance Authority. The criteria for inclusion in the reporting entity and its presentation are defined by the Governmental Accounting Standards Board (GASB) in its GASB Codification Section 2100. These criteria are described in Note 1 of the accompanying financial statements.

The State and its component units provide a broad range of services to its citizens, including k-12 public education; higher education; health and human services; economic development; environment and natural resources; public safety, corrections, and regulation; transportation; agriculture; and general government services. The costs of these services are reflected in detail and in summary in this report.

Budgetary Control

In addition to internal controls discussed previously, the State maintains budgetary controls. The objective of these budgetary controls is to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the General Assembly. Activities of the General Fund and most departmental special revenue funds are included in the annual appropriated budget. The State Highway Fund and the Highway Trust Fund, the State's major special revenue funds, are primarily budgeted on a multi-year basis. Capital projects are funded and planned in accordance with the time it will take to complete the project. The level of budgetary control (that is, the level at which expenditures cannot legally exceed the appropriated amount) is exercised at both the departmental and university level, with allotment control exercised by the State Controller, and on the program line-item levels requiring certain approvals by the Director of the Budget. Legislative authorization of departmental expenditures appears in the State Appropriation Bill. The *certified budget* is the legal expenditure authority; however, the Office of State Budget and Management (OSBM) may approve executive changes to the legal budget as allowed by law. These changes result in the *final budget* presented in the required supplementary information.

Economic Condition

Prospects for Fiscal Year 2006-07

The consensus revenue estimate for the upcoming fiscal year represented a very cautious stance regarding the portion of the 2005-06 revenue surplus counted as recurring. In addition, the economy-based revenue estimates for the year reflect the view that the combination of a rise in short-term interest rates to 5.25% (9.25% for prime rate) and persistently high energy prices will eventually lead to a "mid-decade slowdown" similar to 1984-86 and 1995. The result is that baseline General Fund tax growth is expected to be only 3.3%. This forecast is in line with the downward adjustments made in many states after a second year of strong April income tax payments.

The projection of slower job growth and retail sales is pretty much the same outlook adopted a year ago during the 2005-06 budget discussions. The difference this year has to do with the loss of the underpinning from the robust real estate market. As the weakness in this sector continues to filter through the economy, we think the Federal Reserve will take note and leave short-term rates at the current 5.25% level. If the economic slowdown accelerates, the Federal Reserve may begin to lower rates during the second half of the fiscal year.

An additional reason the 2006-07 economic outlook is cautious is that even if we get the change in direction of the economy and timing right, it is hard to project the magnitude of the decline. There have been numerous occasions in the past when the Federal Reserve overshot the mark and a planned slowdown turned into an outright recession. This has been especially true when the rate hikes are accompanied by external shocks such as a military engagement or a gas price spike.

Barring any unforeseen international events we think that a full-scale recession can be avoided. One reason has to do with stable long-term interest rates. During a typical monetary tightening phase, long-term rates will follow hikes in short-term rates for the first few moves before stabilizing as investors become comfortable that an economic slowdown and lessening of inflation pressures is underway. During the current cycle long-term rates have remained stable throughout the Federal Reserve actions. Part of the reason for the stability has been the continued supply of funds from overseas. The other reason that a full-scale recession can be avoided has to do with the fact that the sharp increase in energy prices has not translated into a major increase in "core inflation" (prices increase excluding the volatile energy and food components).

Though the risks to the economic outlook increased, the cautionary stance taken on the nonrecurring portion of the 2005-06 revenue surplus means that the State is well-positioned for the economic slowdown that is starting to unfold.

— Economic analysis prepared by David Crotts, Economist
North Carolina General Assembly, Fiscal Research Division
October 31, 2006

Issues and Observations

BEACON

BEACON HR/Payroll

The State's current core business systems have limited functionality. They rely on dated technology, do not communicate well with each other, are difficult to change for new operational requirements, and are hard to operate and maintain. Moreover, they do not provide information needed for management decision-making in today's business climate, and they are at risk of failure due to old age, withdrawal of vendor support, and being run by a workforce that is rapidly reaching retirement age.

BEACON is a statewide collaborative effort aimed at transforming the way we do business in North Carolina by modernizing and standardizing key business processes in human resources, payroll, budget management, taxation, data storage and accounting. With the implementation of SAP's Enterprise Resource Planning software solution, the goal of BEACON is to build a foundation for management flexibility, increased efficiency, improved access to information, and ultimately to enhance the quality of services provided to the citizens of North Carolina.

The Office of the State Controller, Information Technology Services, the Office of State Budget and Management, the Office of State Personnel, and the Department of Transportation are overseeing the implementation effort with the full support of Governor Easley and the General Assembly. BEACON will impact many of the systems and processes utilized by state agencies and universities. Representatives from nearly every agency in the State are participating in the design of the new infrastructure.

Session Law 2004-129 appropriated \$2.7 million from the IT Fund to the Office of the State Controller in 2004 to begin implementation of the recommendations found in the Statewide Business Infrastructure Study. Of the \$2.7 million, \$1.8 million was allocated to the HR/Payroll Initiative and \$900 thousand to the Enterprise Data Warehouse Initiative. The fiscal year 2005-06 appropriation for the HR/Payroll project was \$20.875 million. Funding for fiscal year 2006-07 is \$44.3 million. The overall estimated cost for the HR/Payroll project is \$125.5 million. The HR/Payroll project is on budget and on schedule to be operational, with the first agency group brought on-line during January 2008, and the second agency group scheduled to be on-line during April 2008.

For additional information on Beacon, you can access the Beacon website through the Office of the State Controller website at <http://www.ncosc.net>.

Enterprise Data Warehouse Initiative

As part of the BEACON program, the BEACON Steering Committee has identified data warehousing and business intelligence as a key technology infrastructure necessary for delivering better citizen services and more effective operations of State government. In an environment where efficiency, accountability and transparency are paramount to the operations of each and every government entity, it is essential that data formerly housed in disparate "silos" be made available for agency and enterprise reporting and analysis.

The State of North Carolina has undertaken a number of initiatives recently to allow the State to better leverage its data assets. These activities have demonstrated the clear need for a more comprehensive approach to data warehousing and business intelligence in the State. From a statewide perspective, the highest value of business intelligence and data warehousing is realized when information is globally consistent and standardized, enabling decision-makers to query across agencies to perform forecasting, trending and data analysis. The Data Warehousing Needs Assessment revealed a number of immediate opportunities for implementation of data warehousing and business intelligence that would allow agencies to better leverage their data assets to provide improved operations or services.

State Budget Act

On July 20, 2006, the General Assembly passed House Bill 914 State Budget Act to replace the Executive Budget Act. This new legislation is effective July 1, 2007 and will affect budget development and management by simplifying, reorganizing, updating the current budget statutes, and making changes to conform the statutes to the state constitutional provisions governing appropriations. The State Budget Act defines key budget aspects and increases the targeted balance of the General Fund savings reserve from 5 percent to 8 percent of prior year operating appropriations expenditures. The new legislation provides that agency budgets be classified in accordance with generally accepted accounting principles as interpreted by the State Controller.

As part of the implementation of the State Budget Act, several budgetary processes and the State's budget code structure will be reviewed and revised as appropriate. Some revisions are expected to require adjustment to the State's budgetary and accounting systems.

Government Performance Audit

The 2006 General Assembly enacted legislation that established the Government Performance Audit Committee (GPAC). The GPAC will consist of 10 members:

- (i) five members of the House of Representatives appointed by the Speaker of the House of Representatives, and
- (ii) five members of the Senate appointed by the President Pro Tempore of the Senate.

The GPAC committee will contract for a performance audit of the executive branch of state government. The goals of the audit are to evaluate the efficiency and effectiveness of state government, and to identify specific improvements. According to legislation, the audit may examine entire departments, agencies, or institutions, or similar programs in several departments. The results of the audit will be reported on or before February 1, 2008. A Request for Proposal (RFP) will be issued for the government performance audit.

The committee's examination of the efficiency and effectiveness of major management policies, practices, and functions, will include the following areas:

- (1) Planning, budgeting, and program evaluation policies and practices, including an analysis of the compliance of the executive branch with existing planning requirements, such as the Capital Improvement Planning Act, Article 1B of Chapter 143 of the General Statutes;
- (2) Personnel systems operations and management;
- (3) State purchasing operations and management;
- (4) Information technology and telecommunications systems policy, organization, and management; and
- (5) Review of duplications and related or overlapping services or activities for the purpose of coordinating and streamlining programs to achieve consistent and clear objectives.

**Other Post-
Employment
Benefits:
Retiree
Healthcare**

In April 2004, GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* (effective for fiscal year 2006-07, and in June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (effective for fiscal year 2007-08).

Beginning in fiscal year 2006-07, the actuarial data will be disclosed in the notes to the State's CAFR, based on the disclosure requirements for a cost-sharing, multiple-employer plan, and will also be presented as required supplementary information (RSI). The unfunded actuarial liability will not be recorded as an accounting liability but will be disclosed in the notes to the financial statements, and as required supplementary information.

Aon Consulting completed an actuarial valuation of retiree health benefits earned as of December 31, 2005. Aon's report was released on December 7, 2006 by the State Health Plan. The State retiree healthcare benefit is currently funded on a pay-as-you-go basis, with minimal additional accumulation of funds to pay the retiree health benefit. Based on the current funding method with limited accumulation of funds, the actuarial assumptions reflect a short-term discount rate of 4.25%.

The actuarial valuation using the unit credit method indicated an accrued liability of \$23.925 billion for the retiree healthcare plan (\$23.786 billion unfunded), with an annual required contribution (ARC) of \$2.39 billion. This accrued liability and annual required contribution are most indicative of the administration and funding of the current retiree health benefit plan and will be incorporated into the required GASB disclosures in the 2007 CAFR.

Participating employers in the retiree health care benefit plan include the primary government state employees, local education agencies (LEAs), the University of North Carolina, community colleges, and several local governments. For the fiscal year ended June 30, 2006, North Carolina's, retiree healthcare employer contributions equaling 3.8% of payroll were \$476.8 million, representing an annual increase of 25.4%. Retiree healthcare premium costs paid to the State Health Plan were \$411.8 million, representing an annual increase of 14.4%. Plan net assets of \$171.1 million represent an increase of \$68.37 million, or 66.5% from the prior year.

Debt Affordability

The 2004 General Assembly passed legislation creating the Debt Affordability Advisory Committee. The committee is charged, on an annual basis, with advising the Governor and the General Assembly of the estimated debt capacity of the State for the upcoming 10 fiscal years.

The Committee produces the Debt Affordability Study on an annual basis. The report was created to serve as a tool for sound debt management practices by the State of North Carolina. The report provides the Governor and the General Assembly with a basis for assessing the impact of future debt issuance on the State's fiscal position and enables informed decision-making regarding both financing proposals and capital spending priorities. The report also provides a methodology for measuring, monitoring and managing the State's debt levels. The concept of Debt Affordability is widely regarded as an essential management tool. The methodology used in the study to analyze the State's debt position incorporates historical and future trends in debt levels, peer group comparisons and provides recommendations within adopted guidelines. The study also provides recommendations regarding other debt management related policies considered desirable and consistent with the sound management of the State's debt. Such recommendations were developed by incorporating management practices consistent with those utilized by the most highly rated states.

Awards and Acknowledgements

Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of North Carolina for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2005. This was the 12th consecutive year (1994 to 2005) the State has received the prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports.

In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized Comprehensive Annual Financial Report, whose contents conform to program standards. The CAFR must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement program requirements, and we are submitting it to the GFOA.

Acknowledgments

In conclusion, we believe this report provides useful data to all parties using it in evaluating the financial activity of the State of North Carolina. We in the Office of the State Controller express our appreciation to the financial officers throughout the State and to the Office of the State Auditor for their dedicated efforts in assisting us in the preparation of this report. Any questions concerning the information contained in this Comprehensive Annual Financial Report should be directed to the Office of the State Controller at (919) 981-5454.

Respectfully submitted,



Robert L. Powell
State Controller

December 11, 2006

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CERTIFICATE OF ACHIEVEMENT

Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of North Carolina

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2005

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



A handwritten signature in black ink, appearing to read "Thomas J. Blum".

President

A handwritten signature in black ink, appearing to read "Jeffrey R. Emen".

Executive Director

ORGANIZATION OF NORTH CAROLINA STATE GOVERNMENT INCLUDING PRINCIPAL STATE OFFICIALS

EXECUTIVE BRANCH

Council of State

Governor Michael F. Easley		Lieutenant Governor Beverly E. Perdue	
Secretary of State Elaine F. Marshall	State Auditor Leslie W. Merritt, Jr.	State Treasurer Richard H. Moore	Superintendent of Public Instruction Dr. June St. Clair Atkinson
Attorney General Roy A. Cooper, III	Commissioner of Agriculture Steven W. Troxler	Commissioner of Labor Cherie K. Berry	Commissioner of Insurance James E. Long

Cabinet Secretaries — Appointed by the Governor

Administration W. Britt Cobb, Jr.	Correction Theodis Beck	Crime Control and Public Safety Bryan E. Beatty	Cultural Resources Lisbeth C. Evans
Commerce James T. Fain	Environment & Natural Resources William G. Ross, Jr.	Health and Human Services Carmen Hooker Odom	Juvenile Justice and Delinquency Prevention George L. Sweat
Revenue E. Norris Tolson	Transportation W. Lyndo Tippet		

Appointed by Governor, confirmed by Legislature

Office of the State Controller Robert L. Powell State Controller	State Board of Education Howard N. Lee Chairman
---	--

Appointed by State Board of Community Colleges

H. Martin Lancaster President
--

Appointed by University Board of Governors

Erskine B. Bowles President
--

LEGISLATIVE BRANCH**JUDICIAL BRANCH****General Assembly****Senate**

President
**Lieutenant Governor
Beverly E. Perdue**

President Pro Tempore
Marc Basnight

Deputy Pres. Pro Tempore
Charlie Smith Dannelly

Majority Leader
Anthony E. Rand

Minority Leader
Philip E. Berger

**House of
Representatives**

Speaker
James B. Black

Speaker Pro Tempore
Richard T. Morgan

Majority Leader
Joe Hackney

Minority Leader
Joe L. Kiser

**North Carolina
Supreme Court**

Chief Justice
Sarah Parker

Associate Justices
Edward Thomas Brady
Robert H. Edmunds, Jr.
Paul M. Newby
Mark D. Martin
Patricia Timmons-Goodson
George L. Wainwright, Jr.

Administrative
Office of the Courts
Judge Ralph A. Walker
Director

Component Units

**University of North
Carolina System**

The Golden LEAF, Inc.

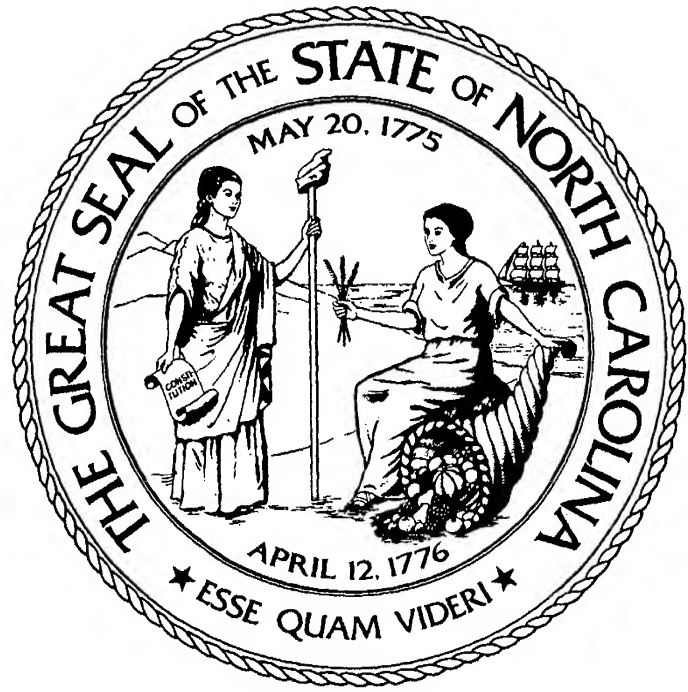
**N.C. Housing Finance
Agency**

Community Colleges

**State Education
Assistance Authority**

**Other Component
Units**

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FINANCIAL SECTION



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State Auditor

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INDEPENDENT AUDITOR'S REPORT

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of North Carolina, as of and for the year ended June 30, 2006, which collectively comprise the State's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the State of North Carolina's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the North Carolina State Lottery Fund, which is both a major fund and 3 percent, 0 percent, and 15 percent, respectively, of the assets, net assets, and revenues of the business-type activities; the financial statements of the 401(K) Supplemental Retirement Income Plan, which represent 4 percent, 5 percent, and 4 percent, respectively, of the assets, net assets, and revenues of the aggregate remaining fund information; the North Carolina Housing Finance Agency, which represent 9 percent, 3 percent, and 3 percent, respectively, of the assets, net assets, and revenues of the aggregate discretely presented component units; the financial statements of the State Education Assistance Authority, which represent 15 percent, 4 percent, and 3 percent, respectively, of the assets, net assets, and revenues of the aggregate discretely presented component units; nor the financial statements of the University of North Carolina System – University of North Carolina Health Care System – Rex Healthcare, which represent 2 percent, 2 percent, and 4 percent, respectively, of the assets, net assets, and revenues of the aggregate discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the 401(K) Supplemental Retirement Income Plan, the State Education Assistance Authority, and the University of North Carolina System – University of North Carolina Health Care System – Rex Healthcare were not audited in accordance with *Governmental Audit Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the State of

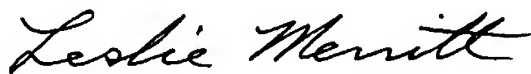
North Carolina, as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 21 to the financial statements, the State changed its method of recognizing individual income taxes and implemented Governmental Accounting Standards Board Statement No. 46, *Net Assets Restricted by Enabling Legislation*, during the year ended June 30, 2006.

In accordance with *Government Auditing Standards*, we will also issue our report dated December 11, 2006 on our consideration of the State of North Carolina's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit. The report on internal control and on compliance and other matters will be published at a later date in the State of North Carolina's *Single Audit Report*.

The Management's Discussion and Analysis; Schedules of Funding Progress – All Defined Benefit Pension Trust Funds; Schedule of Contributions from the Employers and Other Contributing Entities – All Defined Benefit Pension Trust Funds; Schedule of Revenues, Expenditures and Changes in Unreserved Fund Balances – Budget and Actual – General Fund; and the Notes to Required Supplementary Information – Budgetary Reporting, as listed in the table of contents, are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We and the other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the State of North Carolina's basic financial statements. The introductory section, the combining fund financial statements and schedules, and the statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining fund financial statements and schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, based on our audit and the reports of other auditors, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, accordingly, we express no opinion on them.



Leslie W. Merritt, Jr. CPA, CFP
State Auditor

December 11, 2006

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*MANAGEMENT'S
DISCUSSION AND
ANALYSIS*

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

The following is a narrative overview and analysis of the State of North Carolina's (the State) financial performance for the fiscal year ended June 30, 2006. Please read it in conjunction with the transmittal letter at the front of this report and with the State's financial statements, which follow this section.

Financial Highlights

Government-wide Financial Statements:

- The State's total net assets increased by \$2.78 billion or 10.7% as a result of this year's operations. Net assets of governmental activities increased by \$2.46 billion, or 9.9% due, in part, to higher than expected growth in tax revenues. Net assets of business-type activities increased by \$319 million, or 29.2% due to the strong financial results of the Unemployment Compensation Fund. At year-end, net assets of governmental activities and business-type activities totaled \$27.43 billion and \$1.41 billion, respectively.
- Component units reported net assets of \$13.19 billion, an increase of \$1.08 billion or 8.9% from the previous year. About half of the increase (\$509 million) is due to the net increase in capital assets, net of related debt for the University of North Carolina System and community colleges. The capital asset additions were financed in part by state debt proceeds.

Fund Financial Statements:

- The fund balance of the General Fund more than doubled from \$953.51 million at June 30, 2005 (as restated) to \$1.93 billion at June 30, 2006. The increase is explained primarily by higher than expected growth in individual income, corporate income, and sales and use taxes. In fiscal year 2006, the State changed its methodology for reporting individual income taxes, which increased beginning fund balance by \$1.04 billion.
- The fund balance of the Highway Fund increased from \$383.3 million at June 30, 2005 to \$568.79 million at June 30, 2006, an increase of 48.4%. The fund balance growth was attributable to increases in driver's license, vehicle registration and other fees and to increases in gasoline tax collections.
- The fund balance of the Highway Trust Fund decreased substantially from negative \$15.36 million at June 30, 2005 to a negative \$135 million at June 30, 2006. Higher construction inflation and non-appropriated spending for the Governor's "Moving Ahead" program and other legislative initiatives contributed to the larger fund deficit.
- The net assets of the Unemployment Compensation Fund almost doubled from \$258.46 million at June 30, 2005 to \$507.48 million at June 30, 2006. The significant increase is explained by the State's lower unemployment rate and by a 20% surcharge on unemployment contributions.
- The N.C. Education Lottery (Lottery) began selling instant game tickets in March 2006 and Powerball tickets in May 2006. As required by statute, the Lottery's net profit of \$64.59 million was transferred to the Education Lottery Fund (nonmajor special revenue fund).

Capital Assets:

- The State's investment in capital assets (net of accumulated depreciation) was \$29.21 billion, an increase of 5.9% from the previous fiscal year-end.
- This year's major capital asset additions were for highway construction (\$1.4 billion), highway land improvements (\$479 million) and the construction of correctional facilities (\$34 million). Also, construction was completed on two 1,000 bed close custody prisons.

Long-term Debt:

- The State had long-term debt (bonds and similar debt payable) outstanding of \$6.52 billion, an increase of less than 1% from the previous fiscal year-end. The long-term debt balance includes \$709.1 million of special obligation (non-voted) debt issued for governmental activities.
- The State maintained its AAA bond rating with Standard and Poor's and Fitch. In August 2002, Moody's downgraded the State's credit rating for general obligation debt from "AAA" to "Aa1", representing the first time since 1960 that North Carolina had less than a "AAA" rating. In September 2004, Moody's upgraded the State's outlook from stable to positive.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is an introduction to the State's basic financial statements, which comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains additional required supplementary information (General Fund budgetary schedule, pension funding progress and contributions) and other supplementary information (combining financial statements) in addition to the basic financial statements. These components are described below.

Government-wide Financial Statements

The Statement of Net Assets and the Statement of Activities are two financial statements that report information about the State, as a whole, and about its activities that should help answer this question: Is the State, as a whole, better off or worse off as a result of this year's activities? These statements include all non-fiduciary assets and liabilities using the accrual basis of accounting. The current year's revenues and expenses are taken into account regardless of when cash is received or paid. The Statement of Net Assets (page 50) presents all of the State's assets and liabilities, with the difference between the two reported as "net assets". Over time, increases and decreases in net assets measure whether the State's financial position is improving or deteriorating.

The Statement of Activities (pages 52 and 53) presents information showing how the State's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in these statements for some items that will only result in cash flows in future fiscal periods (e.g. uncollected taxes and earned but unused vacation leave).

Both statements report three activities:

Governmental Activities – Most of the State's basic services are reported under this category. Taxes and intergovernmental revenues generally fund these services.

Business-type Activities – The State charges fees to customers to help it cover all or most of the cost of certain services it provides. The State's Unemployment Compensation Fund, the N.C. State Lottery Fund, and the EPA Revolving Loan Fund are the predominant business-type activities.

Discretely Presented Component Units – Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. A description of the component units and an address for obtaining their separately issued financial statements can be found beginning on page 72. All component units are combined and displayed in a separate discrete column in the government-wide financial statements to emphasize their legal separateness from the State. In addition, financial statements for major component units are presented in the notes to the financial statements (pages 145 and 146).

Fund Financial Statements

The fund financial statements provide more detailed information about the State's most significant funds (i.e., major funds) – not the State as a whole. A fund is a fiscal and accounting entity with a self-balancing set of accounts that the State uses to keep track of specific sources of funding and spending for particular purposes. In addition to the major funds, page 170 begins the individual fund data for the non-major funds. The State's funds are divided into three categories, governmental, proprietary, and fiduciary, and they use different accounting approaches.

Governmental funds -- Most of the State's basic services are reported in the governmental funds, which focus on how cash and other financial assets that can readily be converted to cash flow in and out (i.e., inflows and outflows of spendable resources) and the balances left at year-end that are available for spending (i.e., balances of spendable resources). Consequently, the governmental fund financial statements provide a detailed short-term view that helps users determine whether there are more or fewer financial resources that can be spent in the near future to finance the State's programs. The State prepares the governmental fund financial statements using the modified

accrual basis of accounting and a current financial resources measurement focus. Because this information does not encompass the additional long-term focus of the government-wide statements, a reconciliation schedule, which follows each of the governmental fund financial statements, explains the relationships (or differences) between them. Information is presented separately in the governmental fund financial statements for the General Fund, the Highway Fund, and the Highway Trust Fund, all of which are considered to be major funds. Data for all other governmental funds are combined into a single aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the form of combining statements elsewhere in this report.

Proprietary funds -- When the State charges customers for the services it provides, whether to outside customers or to other agencies within the State, these services are generally reported in proprietary funds. Proprietary funds (enterprise and internal service) utilize accrual accounting; the same method used by private sector businesses. Enterprise funds are used to report activities for which fees are charged to external users for goods and services. The Unemployment Compensation Fund, the N.C. State Lottery Fund, and the EPA Revolving Loan Fund are our most significant enterprise funds. Internal service funds are used to report activities that provide goods and services to the State's other programs and activities on a cost-reimbursement basis, such as the State Property Fire Insurance Fund, the Motor Fleet Management Fund, Computing Services Fund, and the State Telecommunications Services Fund. Because the State's internal service funds predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. Information is presented separately in the proprietary fund financial statements for the Unemployment Compensation Fund, the N.C. State Lottery Fund, and the EPA Revolving Loan Fund, all of which are considered to be major funds. Conversely, separately aggregated columns are presented for the nonmajor enterprise funds and the internal service funds. Individual fund data for the nonmajor enterprise funds and internal service funds is provided in the form of combining statements elsewhere in this report.

Fiduciary funds -- Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to the support the State's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds. The State's fiduciary activities are reported in separate Statements of Fiduciary Net Assets and Changes in Fiduciary Net Assets. These funds include pension and other employee benefit trust funds, private-purpose trust funds, investment trust funds, and agency funds.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found beginning on page 70 of this report.

Required Supplementary Information

Following the basic financial statements and notes to the financial statements is Required Supplementary Information (RSI), which accompanies the basic financial statements. The RSI is mandated by the GASB and includes General Fund budgetary comparison schedules reconciling the statutory to the generally accepted accounting principles (GAAP) fund balances at fiscal year-end, and pension plan trend information related to funding progress and contributions.

Other Supplementary Information

Other supplementary information includes the introductory section, the combining financial statements for non-major governmental funds, non-major enterprise funds, internal service funds, fiduciary funds, and non-major discretely presented component units.

FINANCIAL ANALYSIS OF THE STATE AS A WHOLE

Over time, increases or decreases in net assets serve as a useful indicator of whether a government's financial position is improving or deteriorating. The State's combined net assets increased \$2.78 billion or 10.7% over the course of this fiscal year's operations. The net assets of the governmental activities increased \$2.46 billion or 9.9% and business-type activities increased \$319.02 million or 29.2%. The following table was derived from the government-wide Statement of Net Assets:

Net Assets June 30, 2006 and 2005 (dollars in thousands)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2006	2005	2006	2005	2006	2005
Current and other non-						
current assets.....	\$ 15,171,216	\$ 12,609,752	\$ 1,717,372	\$ 1,439,494	\$ 16,888,588	\$ 14,049,246
Capital assets, net.....	29,159,235	27,542,758	53,029	54,645	29,212,264	27,597,403
Total assets.....	44,330,451	40,152,510	1,770,401	1,494,139	46,100,852	41,646,649
Long-term liabilities.....	7,281,649	7,027,869	14,064	13,018	7,295,713	7,040,887
Other liabilities.....	9,614,902	8,152,804	345,662	389,466	9,960,564	8,542,270
Total liabilities.....	16,896,551	15,180,673	359,726	402,484	17,256,277	15,583,157
Net assets:						
Invested in capital assets,						
net of related debt.....	28,035,283	26,435,216	44,196	44,007	28,079,479	26,479,223
Restricted.....	890,802	1,314,397	1,286,477	970,615	2,177,079	2,285,012
Unrestricted.....	(1,491,985)	(2,777,776)	80,002	77,033	(1,411,983)	(2,700,743)
Total net assets.....	\$ 27,433,900	\$ 24,971,837	\$ 1,410,675	\$ 1,091,655	\$ 28,844,575	\$ 26,063,492

The largest component of the State's net assets (\$28.08 billion) reflects its investment in capital assets (land, buildings, machinery and equipment, state highway system, and other capital assets), less related debt still outstanding that was used to acquire or construct those assets. Restricted net assets are the next largest component (\$2.18 billion). Net assets are restricted when constraints placed on their use are 1) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or 2) legally imposed through constitutional provisions. The remaining portion, unrestricted net assets, consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

The government-wide statement of net assets for governmental activities reflects a negative \$1.49 billion unrestricted net asset balance. The State of North Carolina, like many other state and local governments, issues general obligation debt and distributes the proceeds to local governments and component units. The proceeds are used to construct new buildings and renovate and modernize existing buildings on the State's community college and university campuses, assist county governments in meeting their public school building capital needs, and to provide grants and loans to local governments for clean water and natural gas projects. Of the \$6.45 billion of bonds and certificates of participation outstanding at June 30, 2006, \$5.49 billion is attributable to debt issued as state aid to component units (universities and community colleges) and local governments. The balance sheets of component unit and local government recipients reflect ownership of the related constructed capital assets without the burden of recording the debt obligation. The policy of selling general obligation bonds and funneling the cash proceeds to non-primary government (non-State) entities has been in place for decades. However, by issuing such debt, the State is left to reflect significant liabilities on its statement of net assets (reflected in the unrestricted net asset component) without the benefit of recording the capital assets constructed or acquired with the proceeds from the debt issuances. Additionally, as of June 30, 2006, the State's governmental activities have significant unfunded liabilities for compensated absences in the amount of \$374.8 million (see Note 7 to the financial statements). These unfunded liabilities also contribute to the negative unrestricted net asset balance for governmental activities.

The following financial information was derived from the government-wide Statement of Activities and reflects how the State's net assets changed during the fiscal year:

Changes in Net Assets
For the Fiscal Years Ended June 30, 2006 and 2005
(dollars in thousands)

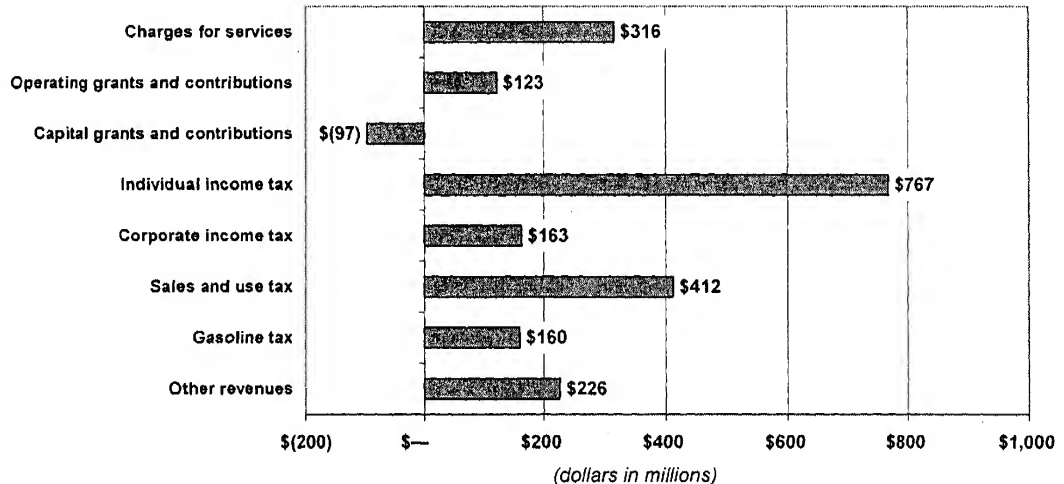
	Governmental Activities		Business-type Activities		Total Primary Government	
	2006	2005	2006	2005	2006	2005
Revenues:						
Program revenues:						
Charges for services.....	\$ 1,988,001	\$ 1,672,482	\$ 1,402,464	\$ 1,145,976	\$ 3,390,465	\$ 2,818,458
Operating grants and contributions.....	11,503,844	11,380,864	64,085	54,760	11,567,929	11,435,624
Capital grants and contributions.....	914,090	1,011,451	258	452	914,348	1,011,903
General revenues:						
Taxes						
Individual income tax.....	9,336,745	8,569,320	—	—	9,336,745	8,569,320
Corporate income tax.....	1,306,193	1,143,458	—	—	1,306,193	1,143,458
Sales and use tax.....	5,033,040	4,621,098	—	—	5,033,040	4,621,098
Gasoline tax.....	1,514,626	1,354,699	—	—	1,514,626	1,354,699
Franchise tax.....	628,029	613,033	—	—	628,029	613,033
Highway use tax.....	577,237	580,118	—	—	577,237	580,118
Insurance tax.....	442,297	442,228	—	—	442,297	442,228
Beverage tax.....	233,315	220,782	—	—	233,315	220,782
Inheritance tax.....	133,158	135,107	—	—	133,158	135,107
Other taxes.....	482,552	306,991	—	—	482,552	306,991
Tobacco settlement.....	140,969	143,586	—	—	140,969	143,586
Unrestricted investment earnings.....	123,170	76,864	—	—	123,170	76,864
Miscellaneous.....	37,248	53,488	4	79	37,252	53,567
Total revenues.....	34,394,514	32,325,569	1,466,811	1,201,267	35,861,325	33,526,836
Expenses:						
General government.....	1,039,513	914,471	—	—	1,039,513	914,471
Primary and secondary education.....	8,215,445	7,698,357	—	—	8,215,445	7,698,357
Higher education.....	3,472,024	3,575,576	—	—	3,472,024	3,575,576
Health and human services.....	13,491,119	13,364,916	—	—	13,491,119	13,364,916
Economic development.....	647,434	621,247	—	—	647,434	621,247
Environment and natural resources.....	676,049	567,252	—	—	676,049	567,252
Public safety, corrections and regulation.....	2,304,900	2,106,656	—	—	2,304,900	2,106,656
Transportation.....	1,781,865	1,795,585	—	—	1,781,865	1,795,585
Agriculture.....	112,467	80,787	—	—	112,467	80,787
Interest on long-term debt.....	264,287	249,433	—	—	264,287	249,433
Unemployment compensation.....	—	—	849,945	824,934	849,945	824,934
N.C. State Lottery.....	—	—	153,125	—	153,125	—
EPA Revolving Loan.....	—	—	11,414	7,170	11,414	7,170
Regulatory commissions.....	—	—	28,526	25,974	28,526	25,974
Insurance programs.....	—	—	16,051	13,535	16,051	13,535
North Carolina State Fair.....	—	—	10,497	10,759	10,497	10,759
Other business-type activities.....	—	—	10,255	9,753	10,255	9,753
Total expenses.....	32,005,103	30,974,280	1,079,813	892,125	33,084,916	31,866,405
Increase (decrease) in net assets before						
contributions and transfers.....	2,389,411	1,351,289	386,998	309,142	2,776,409	1,660,431
Contributions to permanent funds.....	4,674	2,288	—	—	4,674	2,288
Transfers.....	67,978	(11,620)	(67,978)	11,620	—	—
Increase (decrease) in net assets.....	2,462,063	1,341,957	319,020	320,762	2,781,083	1,662,719
Net assets - beginning - restated.....	24,971,837	23,629,880	1,091,655	770,893	26,063,492	24,400,773
Net assets - ending.....	\$ 27,433,900	\$ 24,971,837	\$ 1,410,675	\$ 1,091,655	\$ 28,844,575	\$ 26,063,492

Governmental Activities

For fiscal year 2006, revenues outpaced expenses and when combined with transfers from the State's business-type activities, an increase of \$2.46 billion in net assets resulted for governmental activities. Total revenues increased 6.4% in fiscal year 2006 to \$34.39 billion. The increase in revenues is attributable mostly to higher than expected growth in individual income, corporate income, and sales and use tax collections. Additionally, the legislature increased driver's license, vehicle registration, and other motor vehicle fees, effective October 1, 2005. Gasoline tax collections were higher because of increases in the motor fuels tax rate. Gasoline taxes are indexed to the wholesale price of fuel, which increased rapidly because of Hurricane Katrina. Net transfers-in were much higher in fiscal year 2006 due to the new State lottery.

The following chart reflects the dollar change in the revenues by source of governmental activities between fiscal years 2005 and 2006:

**Dollar Change in Governmental Activities Revenues by Source
Between Fiscal Years 2005 and 2006**



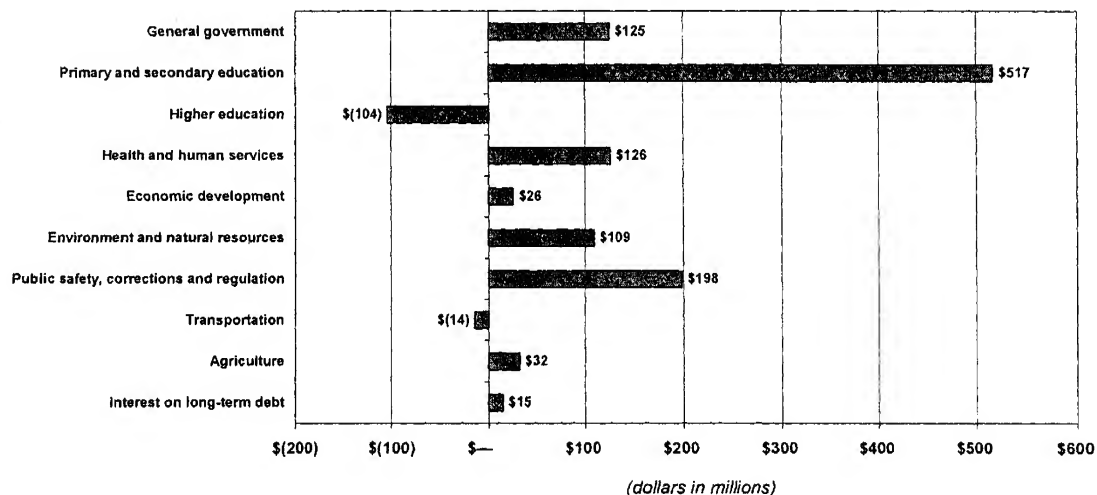
Total expenses increased by only 3.3% to \$32.01 billion, primarily because of minimal growth (less than 1%) in the State's largest functional area, health and human services (HHS). For comparison, HHS expenses increased by 14.1% in 2005 and 10.5% in 2004.

Several factors helped to curb HHS spending. The General Assembly froze the reimbursement rates for most Medicaid service providers to the level authorized in fiscal year 2005. Moreover, the new Medicare Part D prescription drug plan resulted in lower costs to the State for drugs funded by Medicaid. Effective January 1, 2006, Medicare Part D, not Medicaid provides for outpatient prescription drug coverage to dual eligibles (i.e., individuals who are both Medicare and Medicaid eligible). However, because of a clawback provision, State's are required to pay most of their estimated savings to the Medicare program to help finance Part D coverage for low-income beneficiaries. State's are required to pay the federal government 90% of their estimated savings in calendar year 2006 and 75% in subsequent years. Another contributing factor to the slower HHS growth is related to the number of Disproportionate Share Hospital (DSH) payments. Due to the late approval of the State plan and new DSH methodology, only six months of DSH payments were made in fiscal year 2006. Additionally, expenses in prior years were much higher because of new initiatives to the Medicaid program. No new programs or initiatives were added to the Medicaid program for the 2006 fiscal year.

Despite enrollment increases, higher education expenses fell in fiscal year 2006 due to larger distributions of higher education bond proceeds in the prior year. Distributions of bond proceeds to colleges and universities were \$725 million in fiscal year 2005 compared to \$291 million this year. Primary and secondary education expenses continued to grow because of enrollment increases and teacher pay raises and bonuses.

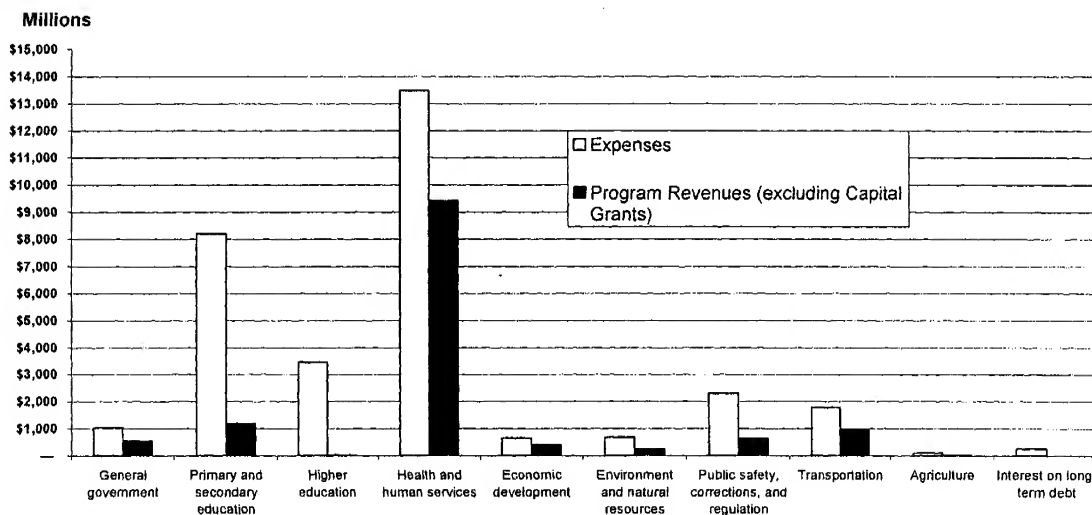
The following chart reflects the dollar change in the functional expenses of governmental activities between fiscal years 2005 and 2006:

Dollar Change in Governmental Activities Functional Expenses Between Fiscal Years 2005 and 2006



The following chart depicts the total expenses and total program revenues of the State's governmental functions. This format identifies the extent to which each governmental function is self-financing through fees and intergovernmental aid or draws from the general revenues of the State.

Expenses - Governmental Activities Fiscal Year Ended June 30, 2006



Business-type Activities

Business-type activities reflect an increase in net assets of \$319.02 million or 29.2%, primarily because of the strong financial results of the Unemployment Compensation Fund. For fiscal year 2006, the Unemployment Compensation Fund had an operating income (excess of operating revenues over operating expenses) of \$253 million. The Unemployment Compensation Fund and the EPA Revolving Loan Fund comprise 90.9% of the total net assets of business-type activities. The N.C. State Lottery Fund has no net assets since its net profits are distributed to the State's governmental activities, as required by statute. A more detailed discussion of the State's business-type enterprise activities is provided in the following section (see Enterprise Funds).

FINANCIAL ANALYSIS OF THE STATE'S FUNDS

The State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental Funds

The focus of the State's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. As of the end of the fiscal year, the State's governmental funds reported combined ending fund balances of \$5.23 billion, a 28% increase from the prior fiscal year-end (as restated). The majority of the increase is related to the revenue growth in the General Fund and Highway Fund (major governmental funds) and to a \$64.59 million transfer from the N.C. State Lottery Fund (major enterprise fund) to the Education Lottery Fund (nonmajor special revenue fund). The lottery funds are required by statute to be used for educational purposes. The major governmental funds are discussed individually below.

General Fund

The General Fund is the chief operating fund of the State. The fund balance of the General Fund more than doubled from \$953.51 million at June 30, 2005 (as restated) to \$1.93 billion at June 30, 2006. The increase is explained primarily by higher than expected growth in individual income, corporate income, and sales and use taxes. For individual income taxes, withholding tax collections grew by 8% and collections of estimated taxes and final payments grew by 21%. The withholding growth rate is similar to that of a pre-recession economy and reflects both job and wage growth. Increases in estimated and final payments also reflect changes in non-wage income. The growth in sales and use taxes occurred despite other offsetting factors, such as higher gas prices and a rise in short-term interest rates. The robust real estate market and improving job market helped to offset these negatives. Corporate income taxes, which are highly volatile over the business cycle, grew primarily because of improved demand for products and services.

For the fiscal year ended June 30, 2006, the State changed its methodology for reporting individual income taxes, which increased beginning fund balance by \$1.04 billion (see Note 21). A more detailed analysis of the General Fund is provided in the budgetary highlights section below.

2005-06 General Fund Budgetary Highlights

The enacted General Fund budget was founded upon an overall nominal economic (real growth plus inflation) growth rate of 4.8% for 2005-06. The appropriated budget included provisions that were designed to increase General Fund revenues. The most significant revenue adjustment was the continuation of two temporary tax increases that were scheduled to expire in 2003. In 2001, the General Assembly temporarily raised the State sales tax rate by a half-cent to 4.5% and the highest individual income tax rate from 7.75% to 8.25%. The 2005-06 budget continued the State sales tax rate at 4.5% and the 8.25% income tax bracket. In addition, the General Assembly approved tax changes to comply with the Streamlined Sales Tax Agreement by equalizing rates of telecommunications, satellite television, candy, and funeral services. North Carolina has now satisfied the terms of the agreement. The budget also included a 25 cents per pack increase in the cigarette tax effective September 1, 2005. The following table summarizes the 2006 revenue enhancements (dollars in millions).

Revenue Enhancements – 2006 Fiscal Year

Maintain State sales tax at 4.5%.....	\$ 417.1
Maintain top income tax rate at 8.25%.....	39.8
Change tobacco tax rate.....	118.8
Change sales, use, and excise taxes.....	54.9
Other changes.....	(7.4)
Total 2006 enhancements.....	\$ 623.2

The majority of funding increases for 2006 were for education, human services, and employee benefit programs. The budget provided full funding for enrollment increases in the public schools (\$135 million), the University of North Carolina System (\$74.2 million), and the community college system (\$7.8 million). In addition, the budget included disadvantaged student supplemental funding (\$22.5 million) and low wealth funds (\$20 million) to enhance public school instructional programs and student achievement throughout the State. Funds were also provided to support at-risk children. These funds include an additional 3,200 slots for the Governor's More-at-Four Program (\$16.6 million), which prepares at-risk four-year-old children for success in school. It also provided funds for ABC teacher bonuses earned in the 2004-05 school year (\$100 million).

The budget provided \$360 million in 2005-06 to support employee benefit programs. Specifically, it contained a 2.25% recurring compensation increase for all staff on the teacher salary schedule, a 2% or \$850 flat amount (whichever is greater) for other state employees, as well as an additional 2% increase for community college faculty and professional staff. In addition, the State Health Plan received funds to cover increased employee health care premiums (\$108.6 million). Finally, the budget included \$25 million to continue repayment of funds withheld from the Retirement System in 2000-01 due to the budget crisis.

State funding for the Medicaid Program totaled \$2.3 billion in 2005-06 and the total Medicaid budget was \$8.8 billion. The General Assembly reduced General Fund appropriations for the Medicaid Program by \$118.8 million in fiscal year 2005-06. The most significant reduction resulted from freezing Medicaid rates for most Medicaid service providers (\$62.5 million). Other reductions include improved utilization management of in-home personal care services, increased recipient co-payments, and further implementation of drug utilization management. The General Assembly also clarified that counties are responsible for paying 15% of the federal Medicare Part D clawback payments under the Medicare Modernization Act of 2004.

General Fund Budget Variances

The original General Fund budget, including state appropriations and appropriations supported by departmental receipts, serves as a starting point or plan for the Governor to execute the General Fund budget pursuant to the powers granted by the Executive Budget Act. At the state level in North Carolina, it is not unusual for the budget to change during the fiscal year in relation to budget adjustments made to accommodate departmental receipts. The General Fund budget supported by state appropriation, is a subset of the General Fund financial schedule presented in the CAFR as required supplementary information. The current CAFR schedule reflects all spending required to support the State's General Fund activities and the funding to support those activities, including state tax and non-tax revenues, federal revenues, student tuition, and other fees, licenses, and fines.

Under current state budget management practice, particularly related to departmental federal receipts, primary emphasis is placed on comparisons of the final authorized budget and actual spending.

At the state level, budgetary cuts related to state appropriations are implemented by decreasing allowable actual expenditures, as opposed to decreasing the state appropriation through a formal legislative process. The Governor and state agencies maintain legal authority to spend the dollars originally appropriated to them; however, in recent years the actual spending has been limited by the collection of tax and nontax revenue. In extremely rare cases, the General Assembly has held special sessions to formally amend the state appropriation budget.

The portion of the original budget comprising departmental receipts is not intended to be the sole controlling point to manage the State's General Fund budget. The final budget includes amendments for departmental receipts collected during the fiscal year as allowed by law. General Fund departmental receipts are typically authorized for expenditure within the activity that generated the receipt. Historically, final estimated receipts have varied significantly from the original estimate at the beginning of the fiscal year. State agencies by law must spend departmental receipts prior to spending tax and nontax supported appropriations. If departmental receipts are higher than expected, appropriated dollars may go unspent and be re-appropriated in a subsequent fiscal year.

Variances – Original and Final Budget

In general, the variances between original and final budget are attributable to the timing and length of the budget preparation process. The original budget for the 2005-06 fiscal year was prepared approximately 18 months prior to the final budget existing at June 30, 2006. The final budget reflects all budget revisions made throughout the fiscal year to adjust for known facts. Furthermore, it cannot be assumed that each agency accurately prepares their budget. Consequently, when the original budget is compared to the final budget, it would be expected that significant variances can occur.

The *federal funds* budget variance between original and final budget was \$1.4 billion. The Department of Public Instruction (DPI) was the primary contributor to the variance, which occurred because of gross understatements of the original federal budget during the continuation budget process. DPI was in the midst of a department-wide reorganization in which the federal funds budget was to be allocated among several different divisions upon completion of the reorganization. As a result, DPI made a one time decision to not estimate its federal funds for fiscal year 2005-06, but to wait until the actual federal fund budget awards were posted by fiscal year 2005-06 budget revisions during the fiscal year.

The budget increase for *intra-governmental transactions* revenue is primarily attributable to the following: \$198.9 million of statewide encumbrance carry forward amounts from fiscal year 2004-2005 and \$143 million of Department of Health and Human Services (DHHS) Medicaid Disproportionate Share. None of these amounts were included in the original budget.

The budget increase for *contributions, gifts, and grants* of \$498.3 million is attributable primarily to DHHS's budgeting of state match throughout the fiscal year, as opposed to including a reasonable original budget estimate. The budget increase for *Universities* of \$237.2 million is attributed to underestimated tuition amounts and the budgeting of fiscal year 2004-05 carry-forward amounts.

For expenditures, the variances between the original budget and final budget are related to the corresponding revenue budget variances. As revenue budget accounts are increased, a corresponding increase occurs in the expenditure budget accounts. In addition to those increases, agency expenditure budgets were also increased by the allocation of statewide reserves, such as the legislative salary increase, hospitalization, retirement, and salary adjustment.

Variances - Final Budget and Actual Results

Actual revenues collected exceeded final budget for several reasons. First, the revenue forecast was on the conservative side of "most likely". Secondly, this forecast was prepared months prior to the beginning of the fiscal year and as the time period between a fiscal year and forecast preparation increases, forecasted amounts become less accurate. Finally, the economy performed much better than anticipated. Strong employment and income growth fueled individual income and sales tax collections that exceeded expectations. In addition, corporate collections continued to surge due to strong corporate profits and improvement in the business climate.

Departmental *federal funds* actually received by agencies were \$1.32 billion less than the final budget. The three agencies primarily responsible for this variance were DPI (\$813.1 million), DHHS (\$348 million), and the Department of Crime Control and Public Safety (\$117.7 million). Actual federal draw downs are reflective of the actual expenditures of these federal funds. Therefore, if qualifying costs are not incurred by an agency, the actual drawdown of federal funds could be significantly less than what has been budgeted. This was the situation in fiscal year 2005-06.

For expenditures, the variances between final budget and actual expenditures for *primary and secondary education, health and human services, and public safety, corrections, and regulation* occurred because actual departmental revenues were less than the budgeted revenues; therefore, expenditures that depended on the receipt of these funds could not be made.

Highway Fund

The Highway Fund dates back to 1921, which is when the N.C. General Assembly first imposed the gasoline tax. It accounts for most of the activities of the North Carolina Department of Transportation (DOT), including the maintenance and construction of the State's primary and secondary road systems, the State Highway Patrol, the Division of Motor Vehicles (DMV), and transit and rail. The primary revenue sources of the Highway Fund are federal funds, three-fourths of gasoline taxes, vehicle registration fees, and driver's license fees.

The fund balance of the Highway Fund increased from \$383.3 million at June 30, 2005 to \$568.79 million at June 30, 2006, an increase of 48.4%. Total revenues increased by \$125.71 million or 4.7% primarily because of increases in gasoline taxes and fees, licenses, and fines. The legislature increased motor vehicle license and registrations fees effective October 1, 2005. These fees include driver's license, vehicle registration, and other fees collected by DMV. Gasoline tax collections rose due to the June 2005 rate increase from 26.6 to 27.1 cents per gallon and a second increase in January 2006 from 27.1 to 29.9 cents per gallon. Gasoline taxes are indexed to the wholesale price of fuel over a six-month period, which increased rapidly following Hurricane Katrina.

Total expenditures decreased by \$79.46 million or 3.1%. This was due to a decrease in costs due to natural disasters compared to the previous fiscal year. In 2005, several major storms affected the western part of the state resulting in significant damage to the road network. DOT also implemented efficiency in cash management initiatives to counteract cash constraints due to escalating inflation. This approach was implemented to offset the effects of construction cost inflationary factors that have averaged 13.5% over the last several years compared to an historical rate of 3.5%. Transfers-in decreased from \$222.16 million in 2005 to \$85.91 million in 2006. Prior to 2002, State match for federal aid projects resulted from interfund transfers from the Highway Trust Fund to the Highway Fund. Due to legislative changes and improved accounting software, the state match is allocated directly from the Highway Trust Fund, eliminating the need for the transfers. The remaining transfer is for projects that were funded prior to this change. As these projects are completed, the transfer balance will continue to decrease.

In September 2004, the State Board of Transportation approved a new long-range plan that prioritizes transportation investment for the next 25 years. The Statewide Transportation Plan provides a blueprint for greater investment in maintenance, preservation, and modernization of the State's existing highway system as well as other transportation options such as rail and public transportation. The share of transportation dollars spent on new highway projects will drop from 45% to 26%. The highway needs of the State's growing population will be accommodated in part by maintaining and upgrading existing roads and by increasing anti-congestion measures such as synchronized traffic signals.

The centerpiece of the plan is the Recommended Investment Scenario (Scenario), which outlines priorities from the estimated \$57 billion, in today's dollars, expected to be available over the next 25 years for transportation investment. Based on the Scenario, the DOT will be able to meet an additional 10% of its maintenance and preservation needs and nearly 25% more modernization infrastructure needs. Additionally, the scenario proposes increasing DOT's investment in other transportation modes. The plan also identifies \$122 billion in total transportation needs and states that DOT will only be able to meet one half of the State's 25-year transportation needs at its current funding levels, regardless of how DOT's resources are allocated. Implementation of the Scenario will be gradual.

Highway Trust Fund

Legislation creating the Highway Trust Fund was passed by the General Assembly in 1989. It was established to provide a dedicated funding mechanism to meet highway construction needs in North Carolina. The Highway Trust Fund also provides extra money for the State's municipalities to adequately maintain their streets and it pays the debt service on the State's general obligation bonds issued for highway purposes.

The principal revenue sources of the Highway Trust Fund are highway use taxes, one-fourth of gasoline taxes, and various title and registration fees. The enabling legislation also specifies that a designated amount will be transferred each year to the General Fund (see Note 9 to the financial statements). The amounts transferred to the General Fund for fiscal years 2006 and 2005 were \$252.55 million and \$243.77 million, respectively. The amount to be transferred for fiscal year 2007 was reduced to \$55 million. The General Assembly enacted legislation during the 2005-06 Session that repealed the requirement for the General Fund to repay the \$125 million (plus interest) advanced from the Highway Trust Fund during the 2002-03 fiscal year. In the prior fiscal year, this advance was reclassified to a transfer to the General Fund.

The fund balance of the Highway Trust Fund decreased substantially from negative \$15.36 million at June 30, 2005 to negative \$135 million at June 30, 2006. Higher construction inflation and non-appropriated spending for the Governor's "Moving Ahead" (see below) and Senate Bill 1005 initiatives, contributed to the larger fund deficit. Total revenues increased by \$45.2 million or 4.4%, primarily because of increases in gasoline taxes and fees, licenses, and fines. The legislature increased motor vehicle license and registrations fees effective October 1, 2005. These fees include title fees and other fees collected by DMV. However, due to a decrease in new vehicle sales, title fee collections were only marginally above the previous year and Highway Use Tax collections were down slightly from the previous year.

Total expenditures decreased by \$188.81 million or 17.9%. This was due to a decrease in contract lettings and lower expenditures in the "Moving Ahead" and Senate Bill 1005 initiatives. The Department implemented efficiency in cash management initiatives as discussed previously.

In 2003, the General Assembly passed the Governor's "Moving Ahead" transportation initiative to allow, over two years, the use of \$630 million of Highway Trust Fund cash balances for highway preservation, modernization, and maintenance. More than 2,200 miles of highway are being improved through "Moving Ahead". Additionally, it allows \$70 million for public transit, rail, ferry, bicycle, and pedestrian projects. Through June 30, 2006, "Moving Ahead" cumulative expenditures totaled \$420.3 million of the \$700 million authorized. For fiscal years 2006 and 2005, transportation expenditures increased by \$132.5 million and \$227.6 million, respectively, due to the advancement of the Governor's "Moving Ahead" transportation initiative.

Bond proceeds of \$300 million were realized in September 2004 to reimburse the Highway Trust Fund for expenditures of prior years. These bonds constitute the remaining portion of the \$950 million highway bond authorization approved by the voters in November 1996 (Note: \$250 million of such bonds were issued in 1997 and \$400 million were issued in 2003). For fiscal year 2006, the debt service on highway bonds was \$93.56 million.

Enterprise Funds

The State's enterprise funds or business-type activities provide the same type of information found in the government-wide financial statements, but in more detail. The major enterprise funds are discussed individually below.

Unemployment Compensation Fund

The net assets of the Unemployment Compensation Fund (Trust Fund) increased by \$249.02 million during the current fiscal year, an increase of 96.4% from the prior fiscal year-end. The net asset growth is explained by the State's lower unemployment rate and by a 20% surcharge on unemployment contributions that became effective January 1, 2005, as required by state statute. The surcharge, which is projected to remain in effect through December 31, 2007, was assessed because of the fund's low reserves in prior years. The State's unemployment rate fell from 5.4 percent in June 2005 to 4.6 percent in June 2006. The State had a net gain of 93,400 jobs, or 2.4% increase, from July 2005 to July 2006, ranking among the national leaders and outpacing the Southeast region. Declines in manufacturing jobs have been more than offset by growth in professional and business services, financial activities, and education and health services. The State unemployment rate is down significantly from the recession peak in 2002, when the rate climbed to 6.7%.

The operating income (excess of operating revenues over operating expenses) was \$253 million this year versus \$244.32 million in 2005. Unemployment benefit expenses increased 3.7% in fiscal year 2006 to \$848.36 million. At June 30, 2006, the short-term debt balance was zero compared to \$113.69 million in 2005. To ensure timely payment of unemployment benefits, the State received repayable advances from its Federal Unemployment Account and issued tax anticipation notes (see attached Note 6 to the financial statements). The State was able to save millions of dollars in interest payments by selling tax anticipation notes instead of borrowing exclusively from the federal government. The use of short-term borrowing came about in early 2002 when an economic downturn caused the State to pay significantly more in unemployment benefits than it received in employer contributions. In May 2006, the State officially ended borrowing from the federal government to cover unemployment benefits. The Trust Fund's cash and cash equivalent balances now equal \$166.7 million.

The 2003 Session of the General Assembly enacted legislation to help preserve the integrity of the unemployment insurance tax system. Session Law 2003-67 (Senate Bill 326) clarifies that an employer cannot avoid an undesirable unemployment insurance rate by shifting employees to a newly created company with a more desirable tax rate. This practice is known as State unemployment tax avoidance or "SUTA dumping."

N.C. State Lottery Fund

The N.C. Education Lottery (Lottery) began operations after July 1, 2005; therefore, the financial statements reflect only a partial fiscal year. The first full time, permanent employee was hired in December 2005. The first lottery tickets (instant game) began selling on March 30, 2006, and the first on-line (Powerball) game tickets began selling on May 30, 2006. The Lottery borrowed \$4 million from the State Treasurer in February 2006 to help cover start-up expenses before the start of ticket sales. These funds were repaid to the State Treasurer in April 2006.

Since the 2005-06 fiscal year was a start-up period, the Lottery had a significant number of initial purchases and one time expenditures for temporary employees. Temporary employees were needed to help operate the Lottery until the permanent staff was hired. As required by the enabling legislation, the Lottery's net profit of \$64.59 million was transferred to the Education Lottery Fund (nonmajor special revenue fund).

The budget for 2006-2007 was approved by the Lottery Commission to provide \$401 million to the Education Lottery Fund. The Lottery is on schedule to complete phase two of its start-up operations by the end of October 2006. Phase one of Lottery operations involved the implementation of instant and Powerball games. Phase two will include both Pick 3 and Pick 5 daily games.

As established in the enabling legislation, lottery funds are to be distributed for educational purposes as follows:

1. 50% to support reduction of class size in early grades and to support prekindergarten programs for at-risk four-year-olds who would otherwise not be served in high-quality settings (*Note: to this point, these programs have been funded by the General Fund*).
2. 40% for public school construction.
3. 10% to the State Education Assistance Authority to fund college and university scholarships.

EPA Revolving Loan Fund

The net assets of the EPA Revolving Loan Fund increased by \$66.75 million during the current fiscal year, which was a 9.4% increase from the prior fiscal year-end. Operating income was \$10.9 million (excess of operating revenues over operating expenses). Net nonoperating revenues were \$47.4 million, consisting primarily of federal capitalization grants and investment earnings. The \$8.7 million transferred in from other governmental funds (i.e., special revenue funds) consisted of clean water bond proceeds and additional funds to meet a required federal match.

Capital Asset and Debt Administration

Capital Assets

As of June 30, 2006, the State's investment in capital assets was \$29.21 billion, an increase of 5.85% from the previous fiscal year-end (see table below).

Capital Assets as of June 30 (net of depreciation, dollars in thousands)

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
Land.....	\$ 9,439,616	\$ 8,913,829	\$ 3,147	\$ 3,147	\$ 9,442,763	\$ 8,916,976
Buildings.....	1,824,190	1,632,941	14,698	15,510	1,838,888	1,648,451
Machinery and equipment.....	566,018	554,484	2,462	1,839	568,480	556,323
Infrastructure:						
State highway system.....	15,368,302	14,247,222	—	—	15,368,302	14,247,222
Other infrastructure.....	77,240	79,058	28,972	30,769	106,212	109,827
Intangible assets.....	105,256	106,045	1,457	1,569	106,713	107,614
Art, literature, and other artifacts.....	60,485	48,975	—	—	60,485	48,975
Construction in progress.....	1,718,128	1,960,204	2,293	1,811	1,720,421	1,962,015
Total.....	\$ 29,159,235	\$ 27,542,758	\$ 53,029	\$ 54,645	\$ 29,212,264	\$ 27,597,403
Total percent change between fiscal years 2005 and 2006	5.87 %		(2.96)%		5.85 %	

This year's major capital asset additions were for highway construction (\$1.4 billion), highway land improvements (\$479 million) and the construction of correctional facilities (\$34 million).

The largest component of capital assets is the State highway system. North Carolina has a 79 thousand mile highway system, making it the second largest state-maintained highway system in the nation. The most recent report on the condition of the State highway system (December 2004) noted that while the system continues to grow, the traditional highway maintenance funds necessary to maintain it have not changed significantly when adjusted for inflation.

The 2002-2003 Session of the General Assembly authorized the issuance of up to \$300 million of special indebtedness to finance the repair and renovation of state facilities and related infrastructure that are supported by the State's General Fund. Of the \$300 million, approximately \$157 million will be allocated to the University of North Carolina System. Each of the 16 constituent institutions of the UNC System will receive a portion of the proceeds for repairs and renovations. The remaining \$143 million of the proceeds will be used to make repairs and renovations to various state facilities. At year-end, the authorized but unissued repair and renovation debt was \$175 million.

In fiscal year 2006, the N.C. Department of Correction completed construction on Maury Correctional Institution (Maury) in Greene County and Bertie Correctional Institution (Bertie) in Bertie County, both of which are 1,000 bed close custody prisons. Maury began accepting inmates in April 2006. Bertie has an inmate occupancy date of August 2006. Total construction and design costs for Maury and Bertie were \$82.3 million and \$84.2 million, respectively. Another 1,000 bed close custody prison is under construction in Columbus County, with an estimated completion date of February 2008. The total estimated cost of this facility is \$104.3 million. The primary funding sources for all three prisons were certificates of participation.

The Department of Correction is undertaking construction initiatives to address a prison cell shortfall and to allow for the implementation of sentencing reform. The State's correctional facility population has more than doubled since 1980 to approximately 38,000 inmates as of November 2006. The rapid growth in inmates is attributable to increases in the State's population, increases in length of stay in correctional facilities, and changes in criminal laws.

As further detailed in Note 20(F) to the financial statements, the State has commitments of \$1.43 billion for the construction of highway infrastructure, which are expected to be financed by gasoline tax collections, motor vehicle fees, and federal funds. Other commitments for the construction and improvement of state government facilities totaled \$580 million, which are expected to be financed primarily by debt proceeds (certificates of participation), state appropriations, and federal funds.

More detailed information about the State's capital assets is presented in Note 5 to the financial statements.

Long-term Debt

At year-end, the State had total long-term debt (bonds and similar debt payable) outstanding of \$6.52 billion, an increase of 0.5% from the previous fiscal year-end (see table below).

Outstanding Debt as of June 30 (dollars in thousands)

	Governmental Activities		Business-type Activities		Total	
	2006	2005	2006	2005	2006	2005
General obligation bonds.....	\$ 5,738,815	\$ 5,698,535	\$ —	\$ —	\$ 5,738,815	\$ 5,698,535
Revenue bonds.....	255,045	265,045	8,800	9,070	263,845	274,115
Certificates of participation.....	454,060	475,170	—	—	454,060	475,170
Notes payable.....	60,841	37,107	1,457	1,569	62,298	38,676
Total.....	<u>\$ 6,508,761</u>	<u>\$ 6,475,857</u>	<u>\$ 10,257</u>	<u>\$ 10,639</u>	<u>\$ 6,519,018</u>	<u>\$ 6,486,496</u>
Total percent change between fiscal years 2005 and 2006	0.51 %		(3.59)%		0.50 %	

During the 2005-06 fiscal year, the State issued \$370 million in general obligation bonds and entered into installment financing contracts (e.g., notes payable) exceeding \$30 million. The new general obligation debt consisted of \$300 million in higher education bonds (see next page) and \$70 million in clean water bonds for providing grants and loans to local government units. The majority of the installment contracts were for the financing of energy conservation improvements at the N.C. Museum of Art and the downtown state government complex. Under these contracts, energy savings are guaranteed to exceed costs. The State is authorized to finance up to \$100 million for energy conservation projects, of which \$76.1 million remains authorized but unissued as of October 31, 2006. The State has undertaken these projects to reduce the use of energy, water, and other utilities in state facilities in order to provide its citizens with an example of energy efficiency.

The State's general obligation bonds are secured by the full faith, credit, and taxing power of the State. The revenue bonds issued by the State are secured solely by specified revenue sources. The certificates of participation (COPs) and lease-purchase revenue bonds issued by the N.C. Infrastructure Finance Corporation, a blended component unit of the State, are secured by lease and installment payments made by the State, and in the event of default, by a security interest in the leased facilities pursuant to a leasehold deed of trust (as applicable). The COPs issued for repair and renovation projects are not secured by a lien upon or security interest in the projects or any other property of the State. Installment financing contracts are secured by a lien on facilities or equipment.

The debt service payments on COPs, lease-purchase revenue bonds, and installment financing contracts are subject to appropriation by the General Assembly. If the State defaulted on its repayments, no deficiency judgment could be rendered against the State, but the state property that serves as security could be disposed of to generate funds to satisfy the debt. Failure to repay the debt would have negative consequences for the State's credit rating. Article 9 of Chapter 142 of the General Statutes prohibits the issuance of special indebtedness (e.g., COPs and lease-purchase revenue bonds) except for projects specifically authorized by the General Assembly. The use of alternative financing methods provides financing flexibility to the State and permits the State to take advantage of changing financial and economic environments.

Higher Education Authorization

The 1999-2000 Session of the General Assembly authorized the issuance of up to \$3.1 billion of higher education improvement bonds, which were subsequently approved by the voters of the State. The \$3.1 billion bond authorization represents the largest debt authorization in the State's history. The proceeds of these general obligation bonds are being used solely to construct new buildings and to renovate and modernize existing buildings on the State's 58 community college and 16 University of North Carolina campuses. These improvements are needed to meet enrollment demands and to ensure that the State's college and university buildings meet modern code requirements and are equipped to prepare graduates for twenty-first century jobs. The bond legislation passed by the General Assembly specifies the amount of bond funding that will flow to each community college and university campus. At year-end, the authorized but unissued higher education bonds were \$403.5 million.

Recent Debt Legislation

The State budget bill for fiscal year 2006-07 authorized the issuance of up to \$672.1 million of special indebtedness (e.g., COPs) to finance the following projects:

- \$40 million to construct new buildings and renovate existing buildings at the N.C. Museum of Art.
- \$20 million to complete the Central Region Psychiatric Hospital for the N.C. Department of Health and Human Services (DHHS).
- \$24.8 million for facility costs of a new Secondary State Data Center.
- \$45.8 million for facility costs of a new Center City Classroom Building at the University of North Carolina at Charlotte.
- \$101 million for facility costs for the DHHS Public Health Laboratory and Office of the Chief Medical Examiner.
- \$145.5 million for facility costs of the Eastern Regional Psychiatric Hospital for DHHS.
- \$132.2 million for facility costs of the Regional Medical Center and Mental Health Center of the N.C. Department of Correction.
- \$162.8 million for facility costs of the Western Regional Psychiatric Hospital for DHHS.

Additional legislation was enacted during the 2005-06 session of the General Assembly that authorized the issuance of special indebtedness of up to \$20 million for the purchase of State game lands and up to \$20 million for the construction of a parking facility in downtown Raleigh.

The previous session of the General Assembly authorized the N.C. Department of Transportation to issue "GARVEE" bonds or other eligible debt financing instruments to finance federal-aid highway projects. These bonds are Grant Anticipation Revenue Vehicles, authorized by federal law, that permit states to use anticipated future federal highway funds to finance highway project construction. According to the Federal Highway Administration, candidate projects for GARVEE financing are typically larger projects that have the following characteristics:

- They are large enough to merit borrowing rather than pay-as-you-go grant funding, with the costs of delay outweighing the costs of financing;
- They do not have access to a revenue stream (such as local taxes or tolls) and other forms of repayment (such as state appropriations) are not feasible; and
- The sponsors (generally state DOTs) are willing to reserve a portion of federal aid highway funds in future years to satisfy debt service requirements.

Total debt would be constrained by the amount of federal aid authorized in the prior federal fiscal year, which was approximately \$953 million for federal fiscal year 2005, the last year for which data is available. More than a dozen other states are already using this type of financing, which Congress authorized in 1995.

Debt Affordability Advisory Committee

During the 2003-04 Session, the General Assembly created a Debt Affordability Advisory Committee (Committee) to annually advise the Governor and the General Assembly on the estimated debt capacity of the State for the upcoming ten fiscal years. The Committee is responsible for preparing an annual debt affordability study and establishing guidelines for evaluating the State's debt burden. The Committee is required to report its findings and recommendations to the Governor, the General Assembly, and the Fiscal Research Division of the General Assembly by February 1 of each year.

In February 2006, the State Treasurer completed the most recent Debt Affordability Study for North Carolina. The report provides the Governor and the General Assembly with a basis for assessing the impact of future debt issuance on the State's fiscal position and enables informed decision-making regarding both financing proposals and capital spending priorities. A secondary purpose of the report is to provide a methodology for measuring, monitoring and managing the State's debt levels, thereby protecting, and perhaps enhancing North Carolina's bond ratings.

The Committee adopted the following target and ceiling guidelines as the preferred measure used to determine the amount of net tax-supported debt that can be prudently authorized by the State:

- Net Tax-Supported Debt Service as a percentage of General Tax Revenues should be targeted at no more than 4% and not exceed 4.75%.

The definition of net tax-supported debt excludes obligations of component units, Highway Fund debt paid from Highway Fund revenues, non tax-supported special indebtedness paid from trust funds, and other self-supporting debt such as revenue bonds and short-term tax anticipation notes.

According to the report, all of the State's debt ratios are below median levels for all 50 states and for a group of six states rated "triple A" by all three rating agencies. Thus, the study concludes that North Carolina's debt is considered low and is manageable at current levels. Credit rating agencies consider a debt affordability study as a positive factor when evaluating issuers and assigning credit ratings.

Credit Ratings

Credit ratings are the rating agencies' assessment of a governmental entity's ability and willingness to repay debt on a timely basis. Credit ratings are an important factor in the public credit markets and can influence interest rates a borrower must pay.

The State's general obligation bonds are rated AAA by Fitch Ratings and AAA with a "stable" outlook by Standard & Poor's Ratings Services, the highest ratings attainable. Moody's Investors Service (Moody's) rates the State's general obligation bonds at Aa1 with a "positive outlook", one half step below their highest rating of Aaa. All three agencies base their prime ratings on the State's strong, diverse economic base, its sound financial management, and low debt levels.

In August 2002, Moody's downgraded the State's credit rating for general obligation debt from "AAA" to "Aa1", representing the first time since 1960 that North Carolina had less than a AAA rating. While Moody's praised the strength of executive powers available to insure a balanced budget, it advised that the primary reasons for the downgrade were the State's continued budget pressure, reliance on non-recurring revenues, and weakened balance sheet. Also, Moody's commented that the task of restoring structural budget balance and rebuilding reserves faces political and economic obstacles. In September 2004, Moody's revised the State's outlook from stable to positive and noted the following:

"This rating reflects the State's slowly stabilizing economy, its improving tax revenues, its conservative debt policy, and its effective financial management. While general fund balances remain negative, flexible cash reserves outside the general fund are ample, and pension funding is exceptionally strong. Moody's expects that the state will continue to take actions to restore structural balance and rebuild reserves."

The COPs and lease-purchase revenue bonds issued by the North Carolina Infrastructure Finance Corporation are rated “AA+” by Standard & Poor’s, “AA+” by Fitch, and “Aa2” by Moody’s.

Limitations on Debt

The Constitution of North Carolina (Article 5, Section 3) imposes limitations upon the increase of certain state debt. It restricts the General Assembly from contracting debts secured by a pledge of the faith and credit of the State, unless approved by a majority of the qualified voters of the State, except for the following purposes:

1. To fund or refund a valid existing debt;
2. To supply an unforeseen deficiency in the revenue;
3. To borrow in anticipation of the collection of taxes due and payable within the current fiscal year to an amount not exceeding 50 percent of such taxes;
4. To suppress riots or insurrections; or to repel invasions;
5. To meet emergencies immediately threatening the public health or safety, as conclusively determined in writing by the Governor; and
6. For any other lawful purpose, to the extent of two-thirds of the amount by which the State’s outstanding indebtedness shall have been reduced during the preceding biennium.

More detailed information about the State’s long-term liabilities is presented in Note 7 to the financial statements.

Next Year’s Budget and Rates

The General Assembly and the Governor adopted a conservative revenue forecast for fiscal year 2006-07. The baseline growth estimate was 3.1%, well below the economic growth forecasts of North Carolina’s university and bank economists.

Tax changes include reducing the State sales tax rate from 4.5% to 4.25% effective December 1, 2006, reducing the top income tax rate from 8.25% to 8% effective January 1, 2007, increasing the cigarette tax from 30 cents to 35 cents per pack effective July 1, 2006, and capping the gasoline tax at current levels. In addition, a \$195.2 million reduction in the transfer from the Highway Trust Fund to the General Fund is recommended for fiscal year 2006-07. This reduction would repay the \$125 million one time borrowing made to offset a budget shortfall as well as the \$80 million inflationary increase adopted in fiscal year 2002-03.

Conditions Expected to Impact Future Operations

State Health Plan

The State Health Plan made available a Preferred Provider Organization (PPO) option to all eligible participants, effective October 1, 2006, as an alternative to the State's indemnity plan. The indemnity plan was the only option that had been offered prior to this time. The PPO option provides for improved health benefits at a lower cost to the State. PPO plans contract with various physicians, hospitals, and other providers to form medical care networks. For the State Health Plan, PPO members receive services at lower premiums and reduced out-of-pocket costs when they use in-network providers. Approximately 330,000 eligible participants selected the new PPO plan offerings during the recent enrollment period. The State Health Plan provides coverage to approximately 600,000 teachers, state employees, and retirees, with a budget of approximately \$2 billion.

Escheats Fund

Legislation passed in 2005 authorized the State Treasurer to diversify the investments of the Escheats Fund. Previously, the Fund was limited to participating in the Long Term Investment Portfolio. The State Constitution mandates that proceeds of the Escheat Fund shall be used to aid needy and worthy North Carolina students enrolled in public institutions of higher education. The continuing demand on resources at the universities and community colleges has necessitated regular tuition increases. The establishment of a modern investment allocation strategy aimed at increasing returns was identified as a way to enhance the Fund's constitutionally provided purpose. Under the new provisions, the State Treasurer is authorized to invest up to 20% of the assets of the Escheats Fund in private equity investments. As of June 30, 2006, \$20 million has been invested into a Real Estate Investment Fund. In fiscal year 2007, investments into public equity and alternative investments funds are expected.

Repayment of Escrowed Retirement Trust Funds

The State withheld \$212.5 million in contributions to the Teachers' and State Employees' Retirement System, the Consolidated Judicial Retirement System, and the Legislative Retirement System to balance the State budget in 2001. The State committed to repaying the funds by 2008. As of June 30, 2006, approximately \$138 million had been repaid. The budget for 2006-07 included another payment to the escrowed debt of \$30 million. The balance of the debt is now \$44.9 million.

Providing Retirement Benefits

It is widely anticipated that the progression of the baby boomer cohort from full-time career status into retirement will have significant economic, social, and political impact throughout the country. Predicting specific ramifications of this phenomenon is difficult. In North Carolina we anticipate some impact to the State's public sector workforce, as boomers increasingly leave active service and retire, and to the state and local government retirement systems. The impact to the retirement systems could be both financial and administrative.

Administratively, the significant increase in the number of retirements to process and maintain will challenge current operations. The total number of members receiving a retirement benefit in the state and local system is approximately 173,000 (includes system retirees, beneficiaries, and members receiving a disability retirement allowance). That number is projected to increase to 345,000 by the year 2025 - an approximate 100% increase in the total number of state and local retirees maintained by the agency over the next 18 years. To help address this need, the Retirement Systems Division is currently increasing organizational efficiencies by implementing a \$34 million replacement of its information technology system that will go-live in October 2007.

Financially, the North Carolina retirement systems are expected to continue the trend of robust fiscal health (the system's funding has averaged 109% for the last 6 years). Any substantive cost increases will not primarily be driven by the cost of providing an actual pension, since employees and employers fund the pension over an employee's service career. However, a significant increase in cost may come from providing cost of living adjustments (COLAs) for a significantly larger retiree pool since those are not pre-funded.

Health Care Benefits for Retirees and Beneficiaries

Based on a unit credit cost method and the State's pay-as-you-go approach as of December 31, 2005, the actuarial results are as follows:

Funding method	Not advance funded
Actuarial cost method	Unit credit
Actuarial accrued liability	\$23.9 billion
Assets	\$ 0.1 billion
Unfunded accrued liability	\$23.8 billion
Annual required contribution	\$ 2.4 billion

The claims cost of 2006 benefits, on a cash basis, was \$539 million. The General Assembly and the Governor are responsible for managing the State's postemployment health care obligations. Any significant changes in benefit or eligibility provisions would be reflected in subsequent actuarial valuations. Additional information about the State's postemployment health care benefits is presented in the letter of transmittal and in Note 13A to the financial statements.

Requests for Information

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the North Carolina Office of the State Controller, Accounting and Financial Reporting Section, 1410 Mail Service Center, Raleigh, N.C. 27699-1410. In addition, this financial report is available on the Office of the State Controller's internet home page at <http://www.ncosc.net/financial/financial.html>.

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*BASIC
FINANCIAL
STATEMENTS*

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*GOVERNMENT-WIDE
FINANCIAL
STATEMENTS*

STATEMENT OF NET ASSETS

June 30, 2006

Exhibit A-1

(Dollars in Thousands)

	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
Assets				
Cash and cash equivalents (Note 3).....	\$ 4,674,651	\$ 451,447	\$ 5,126,098	\$ 2,601,756
Investments (Note 3).....	1,041,445	57,453	1,098,898	3,548,020
Securities lending collateral (Note 3).....	5,367,553	266,780	5,634,333	—
Receivables, net (Note 4).....	3,394,647	406,921	3,801,568	927,829
Due from component units (Note 17).....	12,758	—	12,758	58,817
Due from primary government (Note 17).....	—	—	—	143,726
Internal balances.....	13,620	(13,620)	—	—
Inventories.....	182,467	501	182,968	76,556
Prepaid items.....	14,439	2,213	16,652	15,677
Advances to component units (Note 17).....	25,364	—	25,364	—
Notes receivable, net (Note 4).....	342,149	545,570	887,719	3,787,120
Endowment investments (Note 3).....	57,741	—	57,741	2,096,982
Investment in joint venture.....	—	—	—	8,319
Deferred charges.....	—	107	107	23,725
Securities held in trust.....	43,911	—	43,911	—
Pension assets (Note 11).....	471	—	471	—
Capital assets-nondepreciable (Note 5).....	11,218,229	5,440	11,223,669	1,871,530
Capital assets-depreciable, net (Note 5).....	17,941,006	47,589	17,988,595	6,873,809
Total Assets	44,330,451	1,770,401	46,100,852	22,033,866
Liabilities				
Accounts payable and accrued liabilities.....	1,296,093	44,072	1,340,165	608,306
Medical claims payable.....	983,145	—	983,145	4,917
Unemployment benefits payable.....	—	17,792	17,792	—
Tax refunds payable.....	1,183,801	—	1,183,801	—
Obligations under securities lending.....	5,367,553	266,780	5,634,333	—
Interest payable.....	87,542	33	87,575	51,457
Short-term debt (Note 6).....	—	—	—	139,582
Due to component units (Note 17).....	143,726	—	143,726	58,817
Due to primary government (Note 17).....	—	—	—	12,758
Unearned revenue.....	498,444	16,957	515,401	132,376
Advance from primary government (Note 17).....	—	—	—	25,364
Obligations under reverse repurchase agreements.....	—	—	—	4,615
Deposits payable.....	60	28	88	11,700
Funds held for others.....	54,538	—	54,538	679,255
Long-term liabilities (Note 7):				
Due within one year.....	549,362	587	549,949	972,610
Due in more than one year.....	6,732,287	13,477	6,745,764	6,140,929
Total Liabilities	16,896,551	359,726	17,256,277	8,842,686
Net Assets				
Invested in capital assets, net of related debt.....	28,035,283	44,196	28,079,479	6,332,775
Restricted for:				
Nonexpendable:				
Environment and natural resources.....	56,645	—	56,645	—
Higher education.....	527	—	527	1,420,268
Health and human services.....	200	—	200	—
Expendable:				
Primary and secondary education.....	7,332	—	7,332	—
Higher education.....	540,069	—	540,069	2,475,959
Health and human services.....	153,023	—	153,023	5,798
Economic development.....	1,831	—	1,831	381,801
Environment and natural resources.....	34,348	—	34,348	—
Public safety, corrections, and regulation.....	54,093	—	54,093	—
Transportation.....	11,864	—	11,864	—
Unemployment compensation.....	—	507,477	507,477	—
EPA revolving loan.....	—	775,269	775,269	—
Other purposes.....	30,670	3,731	34,401	32
Unrestricted.....	(1,491,985)	80,002	(1,411,983)	2,574,547
Total Net Assets	\$ 27,433,900	\$ 1,410,675	\$ 28,844,575	\$ 13,191,180

The accompanying Notes to the Financial Statements are an integral part of this statement.

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STATEMENT OF ACTIVITIES

For the Fiscal Year Ended June 30, 2006

(Dollars in Thousands)

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Primary Government:					
Governmental Activities:					
General government.....	\$ 1,039,513	\$ 339,053	\$ 215,409	\$ 1,711	\$ (483,340)
Primary and secondary education.....	8,215,445	23,959	1,163,672	—	(7,027,814)
Higher education.....	3,472,024	300	22,038	—	(3,449,686)
Health and human services.....	13,491,119	295,479	9,139,441	14,582	(4,041,617)
Economic development.....	647,434	26,506	375,654	—	(245,274)
Environment and natural resources.....	676,049	151,698	94,056	77,723	(352,572)
Public safety, corrections, and regulation.....	2,304,900	411,188	223,663	15,520	(1,654,529)
Transportation.....	1,781,865	725,311	256,466	803,487	3,399
Agriculture.....	112,467	14,507	13,445	1,067	(83,448)
Interest on long-term debt.....	264,287	—	—	—	(264,287)
Total Governmental Activities.....	32,005,103	1,988,001	11,503,844	914,090	(17,599,168)
Business-type Activities:					
Unemployment Compensation.....	849,945	1,101,357	5,910	—	257,322
N.C. State Lottery.....	153,125	216,906	808	—	64,589
EPA Revolving Loan.....	11,414	15,237	54,514	—	58,337
Regulatory commissions.....	28,526	33,550	850	—	5,874
Insurance programs.....	16,051	14,860	852	—	(339)
North Carolina State Fair.....	10,497	12,581	109	—	2,193
Other business-type activities.....	10,255	7,973	1,042	258	(982)
Total Business-type Activities.....	1,079,813	1,402,464	64,085	258	386,994
Total Primary Government.....	\$ 33,084,916	\$ 3,390,465	\$ 11,567,929	\$ 914,348	\$ (17,212,174)
Component Units:					
The Golden LEAF, Inc.	\$ 28,773	\$ 5	\$ 48,444	\$ —	\$ 19,676
University of North Carolina System.....	6,650,114	3,903,663	929,272	32,747	(1,784,432)
Community Colleges.....	1,502,874	242,164	452,649	60,971	(747,090)
N.C. Housing Finance Agency.....	251,870	244,466	32,068	—	24,664
State Education Assistance Authority.....	249,312	154,206	38,717	—	(56,389)
Other component units.....	195,104	56,702	20,344	715	(117,343)
Total Component Units.....	\$ 8,878,047	\$ 4,601,206	\$ 1,521,494	\$ 94,433	\$ (2,660,914)

The accompanying Notes to the Financial Statements are an integral part of this statement.

STATEMENT OF ACTIVITIES (continued)

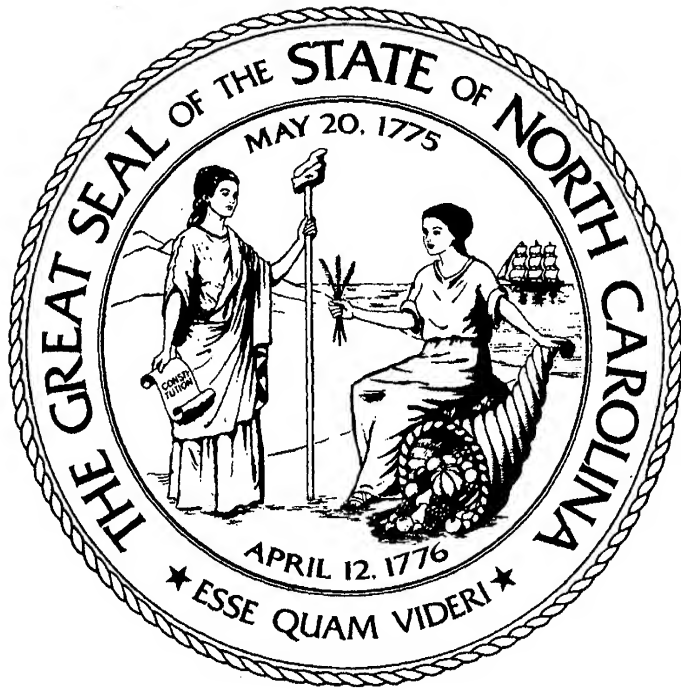
For the Fiscal Year Ended June 30, 2006

Exhibit A-2

(Dollars in Thousands)

	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
Changes in Net Assets:				
Net (expense) revenue	\$ (17,599,168)	\$ 386,994	\$ (17,212,174)	\$ (2,660,914)
General Revenues:				
Taxes:				
Individual income tax.....	9,336,745	—	9,336,745	—
Corporate income tax.....	1,306,193	—	1,306,193	—
Sales and use tax.....	5,033,040	—	5,033,040	—
Gasoline tax.....	1,514,626	—	1,514,626	—
Franchise tax.....	628,029	—	628,029	—
Highway use tax.....	577,237	—	577,237	—
Insurance tax.....	442,297	—	442,297	—
Beverage tax.....	233,315	—	233,315	—
Inheritance tax.....	133,158	—	133,158	—
Other taxes.....	482,552	—	482,552	—
Tobacco settlement.....	140,969	—	140,969	—
Unrestricted investment earnings.....	123,170	—	123,170	—
State operating aid.....	—	—	—	3,132,005
State capital aid.....	—	—	—	489,979
Miscellaneous.....	37,248	4	37,252	10,626
Contributions to permanent funds.....	4,674	—	4,674	—
Contributions to endowments.....	—	—	—	109,747
Transfers.....	67,978	(67,978)	—	—
Total general revenues, contributions and transfers.....	20,061,231	(67,974)	19,993,257	3,742,357
Change in net assets.....	2,462,063	319,020	2,781,083	1,081,443
Net assets — July 1, as restated (Note 22).....	24,971,837	1,091,655	26,063,492	12,109,737
Net assets — June 30.....	\$ 27,433,900	\$ 1,410,675	\$ 28,844,575	\$ 13,191,180

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FUND FINANCIAL STATEMENTS

BALANCE SHEET
GOVERNMENTAL FUNDS

June 30, 2006

Exhibit B-1

(Dollars in Thousands)

	General Fund	Highway Fund	Highway Trust Fund	Other Governmental Funds	Total Governmental Funds
Assets					
Cash and cash equivalents (Note 3).....	\$ 2,421,376	\$ 589,757	\$ 21,766	\$ 1,577,952	\$ 4,610,851
Investments (Note 3).....	2,014	—	—	1,018,515	1,020,529
Securities lending collateral (Note 3).....	3,763,630	532,421	23,001	1,009,392	5,328,444
Receivables, net: (Note 4)					
Taxes receivable.....	1,790,815	107,306	37,855	2,317	1,938,293
Accounts receivable.....	258,855	10,588	392	24,217	294,052
Intergovernmental receivable.....	1,061,100	56,789	2,529	7,445	1,127,863
Interest receivable.....	13,835	391	518	7,433	22,177
Other receivables.....	—	2,102	—	—	2,102
Due from other funds (Note 9).....	5,690	75,495	105	57,927	139,217
Due from component units (Note 17).....	2,438	—	—	9,240	11,678
Inventories.....	73,343	74,991	—	33,818	182,152
Prepaid items.....	—	—	—	991	991
Advances to component units (Note 17).....	—	—	3,622	21,742	25,364
Notes receivable, net (Note 4).....	6,578	1,102	107	334,362	342,149
Securities held in trust.....	565	4,546	—	38,800	43,911
Endowment investments (Note 3).....	—	—	—	57,741	57,741
Total Assets	\$ 9,400,239	\$ 1,455,488	\$ 89,895	\$ 4,201,892	\$ 15,147,514
Liabilities and Fund Balances					
Liabilities:					
Accounts payable and accrued liabilities:					
Accounts payable.....	\$ 79,077	\$ 192,114	\$ 70,579	\$ 85,463	\$ 427,233
Accrued payroll.....	6,529	19,193	—	813	26,535
Intergovernmental payable.....	602,461	94,645	54,768	9,758	761,632
Claims payable.....	—	—	—	32,632	32,632
Medical claims payable.....	983,145	—	—	—	983,145
Tax refunds payable.....	1,183,801	—	—	—	1,183,801
Obligations under securities lending.....	3,763,630	532,421	23,001	1,009,392	5,328,444
Interest payable.....	655	—	—	—	655
Due to fiduciary funds (Note 9).....	42,541	—	—	47	42,588
Due to other funds (Note 9).....	14,180	8,544	75,495	41,853	140,072
Due to component units (Note 17).....	48,446	—	—	95,280	143,726
Deferred revenue.....	749,622	25,014	1,050	13,282	788,968
Deposits payable.....	51	—	—	9	60
Funds held for others.....	903	14,772	—	38,863	54,538
Total Liabilities	7,475,041	886,703	224,893	1,327,392	9,914,029
Fund Balances:					
Reserved (Note 10).....	155,418	53,999	3,729	903,408	1,116,554
Unreserved/Designated.....	656,731	—	—	—	656,731
Unreserved/Undesignated, reported in:					
General Fund.....	1,113,049	—	—	—	1,113,049
Special Revenue Funds.....	—	514,786	(138,727)	1,856,141	2,232,200
Capital Projects Funds.....	—	—	—	113,433	113,433
Permanent Funds.....	—	—	—	1,518	1,518
Total Fund Balance	1,925,198	568,785	(134,998)	2,874,500	5,233,485
Total Liabilities and Fund Balances	\$ 9,400,239	\$ 1,455,488	\$ 89,895	\$ 4,201,892	\$ 15,147,514

The accompanying Notes to the Financial Statements are an integral part of this statement.

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE STATEMENT OF NET ASSETS

June 30, 2006

Exhibit B-1a

(Dollars in Thousands)

Total fund balances - governmental funds (see Exhibit B-1) \$ 5,233,485

Amounts reported for governmental activities in the Statement of Net Assets are different because:

- **Capital assets** used in governmental activities are not financial resources and, therefore, are not reported in the funds (see Note 5). These consist of:

Cost of capital assets (excluding internal service funds).....	\$ 29,494,748	
Less: Accumulated depreciation (excluding internal service funds).....	(431,249)	
Net capital assets.....		29,063,499
- **Some assets**, such as receivables, are not available soon enough to pay for current-period expenditures and thus, are offset by deferred revenue in the governmental funds.

		297,302
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- **Pension assets**, resulting from contributions in excess of the annual required contribution are not financial resources and, therefore, are not reported in the funds (see Note 11).

		471
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- **Long-term debt instruments**, such as bonds and notes payable, are not due and payable in the current period and, therefore, the outstanding balances are not reported in the funds (see Note 7). Also, unamortized debt premiums, discounts, and losses on refundings are reported in the Statement of Net Assets but are not reported in the funds. These balances consist of:

General obligation bonds payable.....	(5,738,815)	
Lease-purchase revenue bonds payable.....	(255,045)	
Certificates of participation payable.....	(454,060)	
Unamortized debt premiums (to be amortized as interest expense).....	(313,253)	
Less: Unamortized debt discounts (to be amortized as interest expense).....	721	
Less: Unamortized loss on refunding (to be amortized as interest expense).....	103,059	
Notes payable.....	(60,841)	
Capital leases payable.....	(26,879)	
Net long-term debt.....		(6,745,113)
- **Other liabilities** not due and payable in the current period and, therefore, not reported in the funds (see Note 7 as applicable) consist of:

Accrued interest payable.....	(86,887)	
Compensated absences (excluding internal service funds).....	(370,934)	
Obligations for workers compensation.....	(5,266)	
Arbitrage rebate payable.....	(508)	
Deferred death benefit payable.....	(340)	
Cost settlement payable.....	(154,000)	
Net pension obligation.....	(1,627)	
Total other liabilities.....		(619,562)
- **Internal service funds** are used by management to charge the costs of certain activities to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the Statement of Net Assets (see Exhibit B-3).

		203,818
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Total net assets - governmental activities (see Exhibit A-1) \$ 27,433,900

The accompanying Notes to the Financial Statements are an integral part of this statement.

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES

GOVERNMENTAL FUNDS

For the Fiscal Year Ended June 30, 2006

Exhibit B-2

(Dollars in Thousands)

	General Fund	Highway Fund	Highway Trust Fund	Other Governmental Funds	Total Governmental Funds
Revenues:					
Taxes:					
Individual income tax.....	\$ 9,493,714	\$ —	\$ —	\$ 1,735	\$ 9,495,449
Corporate income tax.....	1,208,356	—	—	98,199	1,306,555
Sales and use tax.....	5,007,567	—	—	26,836	5,034,403
Gasoline tax.....	—	1,114,743	372,072	27,927	1,514,742
Franchise tax.....	628,665	—	—	—	628,665
Highway use tax.....	—	—	577,237	—	577,237
Insurance tax.....	431,729	—	—	10,568	442,297
Beverage tax.....	232,987	—	—	328	233,315
Inheritance tax.....	133,248	—	—	—	133,248
Other taxes.....	335,820	—	—	146,734	482,554
Federal funds.....	9,905,879	993,867	—	415,976	11,315,722
Local funds.....	574,300	14,778	1,976	19,447	610,501
Investment earnings.....	262,904	38,343	3,018	79,749	384,014
Interest earnings on loans.....	—	7	—	5,398	5,405
Sales and services.....	95,178	813	—	164,547	260,538
Rental and lease of property.....	7,942	13,399	1,434	3,207	25,982
Fees, licenses, and fines.....	501,018	597,326	106,348	200,877	1,405,569
Tobacco settlement.....	136,453	—	—	—	136,453
Contributions, gifts, and grants.....	17,633	1,946	868	98,489	118,936
Funds escheated.....	—	—	—	108,075	108,075
Miscellaneous.....	131,843	13,288	2,053	13,868	161,052
Total revenues.....	<u>29,105,236</u>	<u>2,788,510</u>	<u>1,065,006</u>	<u>1,421,960</u>	<u>34,380,712</u>
Expenditures:					
Current:					
General government.....	869,092	—	—	94,807	963,899
Primary and secondary education.....	7,954,919	—	—	257,079	8,211,998
Higher education.....	3,060,173	—	—	411,431	3,471,604
Health and human services.....	13,230,073	—	—	87,998	13,318,071
Economic development.....	242,953	—	—	400,557	643,510
Environment and natural resources.....	249,692	—	—	376,750	626,442
Public safety, corrections, and regulation.....	1,894,345	—	—	397,251	2,291,596
Transportation.....	—	2,448,816	770,733	—	3,219,549
Agriculture.....	102,256	—	—	8,370	110,626
Capital outlay.....	—	—	—	270,882	270,882
Debt service:					
Principal retirement.....	312,524	—	54,675	747	367,946
Interest and fees.....	248,168	—	38,883	1,037	288,088
Debt issuance costs.....	508	—	—	1,137	1,645
Total expenditures.....	<u>28,164,703</u>	<u>2,448,816</u>	<u>864,291</u>	<u>2,308,046</u>	<u>33,785,856</u>
Excess revenues over (under) expenditures.....	<u>940,533</u>	<u>339,694</u>	<u>200,715</u>	<u>(886,086)</u>	<u>594,856</u>
Other Financing Sources (Uses):					
Bonds issued.....	—	—	—	370,000	370,000
Other debt issued.....	3,857	3,000	—	23,831	30,688
Premium on debt issued.....	—	—	—	16,338	16,338
Capital leases.....	—	—	—	26,745	26,745
Sale of capital assets.....	8,313	5,773	571	5,474	20,131
Insurance recoveries.....	411	5,203	—	923	6,537
Transfers in (Note 9).....	625,532	85,906	1,321	1,071,463	1,784,222
Transfers out (Note 9).....	(620,313)	(255,040)	(322,243)	(520,989)	(1,718,585)
Total other financing sources (uses).....	<u>17,800</u>	<u>(155,158)</u>	<u>(320,351)</u>	<u>993,785</u>	<u>536,076</u>
Net change in fund balances.....	<u>958,333</u>	<u>184,536</u>	<u>(119,636)</u>	<u>107,699</u>	<u>1,130,932</u>
Fund balances — July 1, as restated (Note 22).....	953,509	383,302	(15,362)	2,766,045	4,087,494
Increase (decrease) in reserve for related assets.....	13,356	947	—	756	15,059
Fund balances — June 30.....	<u>\$ 1,925,198</u>	<u>\$ 568,785</u>	<u>\$ (134,998)</u>	<u>\$ 2,874,500</u>	<u>\$ 5,233,485</u>

The accompanying Notes to the Financial Statements are an integral part of this statement.

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

For the Fiscal Year Ended June 30, 2006

Exhibit B-2a

(Dollars in Thousands)

Net change in fund balances - total governmental funds (see Exhibit B-2) **\$ 1,130,932**

Amounts reported for governmental activities in the Statement of Activities are different because:

- Capital outlays are reported as expenditures in governmental funds. However, in the Statement of Activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current period, these amounts are:		
Capital outlays (including construction-in-progress)	\$ 2,200,513	
Less: Depreciation expense (excluding internal service funds)	(564,014)	
Net capital outlay adjustment		1,636,499
- Proceeds from the sale of capital assets increase financial resources in the funds, whereas in the Statement of Activities only the gain or loss on the sale is reported. This adjustment reduces the proceeds by the book value of the capital assets sold.		
		(37,207)
- Donations of capital assets do not appear in the governmental funds because they are not financial resources, but increase net assets in the Statement of Activities.		
		14,582
- Long-term debt proceeds provide current financial resources to governmental funds, while the repayment of the related debt principal consumes those financial resources. These transactions, however, have no effect on net assets. Also, governmental funds report the effect of premiums and similar items when debt is first issued, whereas these amounts are deferred and amortized in the Statement of Activities. In the current period, these amounts consist of:		
Debt issued or incurred:		
Bonds and similar debt issued	(400,688)	
Capital lease financings	(26,745)	
Premiums on debt issued	(15,700)	
Principal repayments:		
Bonds, notes, and similar debt	367,783	
Capital leases	163	
Net debt adjustments		(75,187)
- Some revenues in the Statement of Activities do not provide current financial resources and, therefore, are deferred in the funds. Also, revenues related to prior periods that became available during the current period are reported in the funds but are eliminated in the Statement of Activities. This amount is the net adjustment.		
		(51,751)
- Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not recognized in the funds. Also, some payments related to prior periods are recognized in the funds but are eliminated in the Statement of Activities. In the current period, the net adjustments consist of:		
Accrued interest	(1,375)	
Compensated absences (excluding internal service funds)	(53,499)	
Workers compensation	234	
Arbitrage rebate	(508)	
Deferred death benefit	60	
Cost settlement	(149,000)	
Net pension obligation	481	
Amortization of deferred amounts	24,403	
Net expense accruals		(179,204)
- Inventories of governmental funds are recorded as expenditures when purchased but in the Statement of Activities are recorded as expenses when consumed.		
		15,059
- Internal service funds are used by management to charge the costs of certain activities to individual funds. The net revenues of internal service funds are included with governmental activities in the Statement of Activities (see Exhibit B-4).		
		8,340

Change in net assets - governmental activities (see Exhibit A-2)

\$ 2,462,063

The accompanying Notes to the Financial Statements are an integral part of this statement.

STATEMENT OF NET ASSETS PROPRIETARY FUNDS

June 30, 2006

(Dollars in Thousands)

	Business-type Activities — Enterprise Funds				
	Unemployment Compensation Fund	EPA Revolving Loan Fund	N.C. State Lottery Fund	Other Enterprise Funds	Total Enterprise Funds
Assets					
Current Assets:					
Cash and cash equivalents (Note 3).....	\$ 166,745	\$ 221,963	\$ 18,500	\$ 42,612	\$ 449,820
Investments (Note 3).....	—	4,268	—	49,454	53,722
Securities lending collateral (Note 3).....	12,738	190,362	16,064	47,616	266,780
Receivables: (Note 4)					
Accounts receivable, net.....	24,919	—	10,047	7,140	42,106
Intergovernmental receivables.....	—	103	—	—	103
Interest receivable.....	49	3,910	184	27	4,170
Premiums receivable.....	—	—	—	1,257	1,257
Contributions receivable, net.....	359,285	—	—	—	359,285
Notes receivable, net (Note 4).....	—	32,429	—	—	32,429
Due from fiduciary funds (Note 9).....	—	—	—	—	—
Due from other funds (Note 9).....	59	—	—	—	59
Due from component units (Note 17).....	—	—	—	—	—
Inventories.....	—	—	—	501	501
Prepaid items.....	—	—	—	2,213	2,213
Total current assets.....	563,795	453,035	44,795	150,820	1,212,445
Noncurrent Assets:					
Restricted/designated cash and cash equivalents (Note 3).....	—	—	—	1,627	1,627
Investments (Note 3).....	—	—	—	462	462
Restricted investments (Note 3).....	—	—	—	3,269	3,269
Notes receivable, net (Note 4).....	—	513,141	—	—	513,141
Deferred charges.....	—	—	—	107	107
Capital assets-nondepreciable (Note 5).....	—	—	—	5,440	5,440
Capital assets-depreciable, net (Note 5).....	—	110	625	46,854	47,589
Total noncurrent assets.....	—	513,251	625	57,759	571,635
Total Assets.....	563,795	966,286	45,420	208,579	1,784,080
Liabilities					
Current Liabilities:					
Accounts payable and accrued liabilities:					
Accounts payable.....	12,638	100	9,927	842	23,507
Accrued payroll.....	—	1	2	107	110
Intergovernmental payable.....	3,194	15	—	—	3,209
Claims payable.....	—	—	—	11,969	11,969
Other payables.....	—	—	5,277	—	5,277
Unemployment benefits payable.....	17,792	—	—	—	17,792
Obligations under securities lending.....	12,738	190,362	16,064	47,616	266,780
Interest payable.....	—	—	—	33	33
Due to other funds (Note 9).....	—	8	13,626	45	13,679
Unearned revenue.....	9,956	—	—	7,001	16,957
Deposits payable.....	—	—	—	28	28
Notes Payable.....	—	—	—	112	112
Bonds payable - current.....	—	—	—	280	280
Compensated absences - current.....	—	39	—	156	195
Total current liabilities.....	56,318	190,525	44,896	68,189	359,928
Noncurrent Liabilities:					
Notes payable.....	—	—	—	1,345	1,345
Bonds payable, net.....	—	—	—	8,520	8,520
Compensated absences.....	—	382	524	2,706	3,612
Total noncurrent liabilities.....	—	382	524	12,571	13,477
Total Liabilities.....	56,318	190,907	45,420	80,760	373,405
Net Assets					
Invested in capital assets, net of related debt.....	—	110	625	43,461	44,196
Restricted for:					
Capital outlay.....	—	—	—	2,629	2,629
Other purposes.....	—	—	—	1,102	1,102
Unrestricted.....	507,477	775,269	(625)	80,627	1,362,748
Total Net Assets.....	\$ 507,477	\$ 775,379	\$ —	\$ 127,819	\$ 1,410,675

The accompanying Notes to the Financial Statements are an integral part of this statement.

Exhibit B-3

Governmental
Activities —
Internal
Service
Funds

\$ 63,800
20,916
39,109

9,774

—

97

261

—

—

28

15,699

1,080

315

13,448

164,527

—

—

—

—

—

4,109

91,627

95,736

260,263

3,868

429

116

1,060

—

—

39,109

—

1,224

6,778

—

—

—

326

52,910

—

—

3,535

3,535

56,445

95,736

—

—

108,082

\$ 203,818

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS PROPRIETARY FUNDS

For the Fiscal Year Ended June 30, 2006

(Dollars in Thousands)

	Business-type Activities — Enterprise Funds				
	Unemployment Compensation Fund	EPA Revolving Loan Fund	N.C. State Lottery Fund	Other Enterprise Funds	Total Enterprise Funds
Operating Revenues:					
Employer unemployment contributions.....	\$ 1,067,977	\$ —	\$ —	\$ —	\$ 1,067,977
Federal funds.....	33,380	—	—	—	33,380
Sales and services.....	—	2,628	215,428	993	219,049
Sales and services used as security for bonds, net.....	—	—	—	2,377	2,377
Interest earnings on loans.....	—	12,609	—	—	12,609
Rental and lease earnings.....	—	—	—	5,537	5,537
Fees, licenses and fines.....	—	—	1,478	45,014	46,492
Insurance premiums.....	—	—	—	14,860	14,860
Miscellaneous.....	—	—	—	183	183
Total operating revenues.....	1,101,357	15,237	216,906	68,964	1,402,464
Operating Expenses:					
Personal services.....	—	3,107	5,700	26,725	35,532
Supplies and materials.....	—	13	252	1,530	1,795
Services.....	—	913	25,541	14,013	40,467
Cost of goods sold.....	—	—	—	424	424
Depreciation/amortization.....	—	21	76	2,983	3,080
Lottery prizes.....	—	—	118,974	—	118,974
Claims.....	—	—	—	9,811	9,811
Unemployment benefits.....	848,359	—	—	—	848,359
Insurance and bonding.....	—	—	4	3,705	3,709
Other.....	—	250	2,142	3,718	6,110
Total operating expenses.....	848,359	4,304	152,689	62,909	1,068,261
Operating income (loss).....	252,998	10,933	64,217	6,055	334,203
Nonoperating Revenues (Expenses):					
Noncapital grants.....	1,913	40,260	—	222	42,395
Noncapital gifts.....	—	—	—	163	163
Investment earnings.....	3,997	14,254	808	2,066	21,125
Interest and fees.....	(782)	—	(31)	(433)	(1,246)
Insurance recoveries.....	—	—	—	389	389
Gain (loss) on sale of equipment.....	—	(2)	—	4	2
Miscellaneous.....	(804)	(7,108)	(405)	(1,974)	(10,291)
Total nonoperating revenues (expenses)...	4,324	47,404	372	437	52,537
Income (loss) before contributions and transfers.....	257,322	58,337	64,589	6,492	386,740
Capital contributions.....	—	—	—	258	258
Transfers in (Note 9).....	—	8,686	—	2,155	10,841
Transfers out (Note 9).....	(8,300)	(273)	(64,589)	(5,657)	(78,819)
Change in net assets.....	249,022	66,750	—	3,248	319,020
Net assets — July 1, as restated (Note 22).....	258,455	708,629	—	124,571	1,091,655
Net assets — June 30.....	\$ 507,477	\$ 775,379	\$ —	\$ 127,819	\$ 1,410,675

The accompanying Notes to the Financial Statements are an integral part of this statement.

Exhibit B-4

**Governmental
Activities —
Internal
Service
Funds**

\$	—
	—
	228,574
	—
	—
	8
	38
	18,666
	569
	<u>247,855</u>
	45,255
	14,447
	105,173
	511
	26,986
	—
	1,242
	—
	9,850
	37,978
	<u>241,442</u>
	<u>6,413</u>
	—
	—
	1,838
	—
	132
	(952)
	<u>(1,432)</u>
	<u>(414)</u>
	5,999
	—
	2,501
	<u>(160)</u>
	8,340
	195,478
\$	<u>203,818</u>

STATEMENT OF CASH FLOWS PROPRIETARY FUNDS

For the Fiscal Year Ended June 30, 2006

(Dollars in Thousands)

	Business-type Activities — Enterprise Funds				
	Unemployment Compensation Fund	EPA Revolving Loan Fund	N.C. State Lottery Fund	Other Enterprise Funds	Total Enterprise Funds
Cash Flows From Operating Activities:					
Receipts from customers.....	\$ 1,077,312	\$ 2,628	\$ 190,805	\$ 65,684	\$ 1,336,429
Receipts from federal agencies.....	33,380	—	—	—	33,380
Receipts from other funds.....	—	—	—	379	379
Payments to suppliers.....	—	(1,010)	(7,975)	(21,972)	(30,957)
Payments to employees.....	—	(3,005)	(4,670)	(25,993)	(33,668)
Payments for prizes, benefits and claims.....	(851,488)	—	(108,106)	(9,186)	(968,780)
Payments to other funds.....	—	—	—	(226)	(226)
Other receipts (payments).....	—	(134)	—	(1,371)	(1,505)
Net cash flows provided (used) by operating activities.....	259,204	(1,521)	70,054	7,315	335,052
Cash Provided From (Used For)					
Noncapital Financing Activities:					
Grant receipts (refunds).....	1,913	40,179	—	222	42,314
Proceeds from short-term borrowing.....	333,319	—	—	—	333,319
Principal payments from short-term borrowing.....	(447,009)	—	—	—	(447,009)
Interest expense and issuance cost.....	(782)	—	(31)	—	(813)
Transfers from other funds.....	—	8,686	—	2,087	10,773
Transfers to other funds.....	(8,300)	(273)	(51,042)	(5,657)	(65,272)
Gifts.....	—	—	—	163	163
Total cash provided from (used for) noncapital financing activities.....	(120,859)	48,592	(51,073)	(3,185)	(126,525)
Cash Provided From (Used For)					
Capital Financing Activities:					
Acquisition and construction of capital assets.....	—	—	(700)	(752)	(1,452)
Proceeds from the sale of capital assets.....	—	—	—	149	149
Capital contributions.....	—	—	—	40	40
Principal paid on capital debt.....	—	—	—	(270)	(270)
Interest paid on capital debt.....	—	—	—	(364)	(364)
Payment to bond escrow agent.....	—	—	—	(46)	(46)
Insurance recoveries.....	—	—	—	389	389
Total cash provided from (used for) capital financing activities.....	—	—	(700)	(854)	(1,554)
Cash Provided From (Used For)					
Investment Activities:					
Purchase of non-State Treasurer investments.....	—	—	—	(179)	(179)
Purchase into State Treasurer investment pool.....	—	(1,684)	—	(12,000)	(13,684)
Redemptions from State Treasurer investment pool.....	—	2	—	—	2
Loan issuances.....	—	(85,438)	—	—	(85,438)
Loan repayments — interest.....	—	12,101	—	—	12,101
Loan repayments — principal.....	—	31,970	—	—	31,970
Investment earnings.....	3,168	6,908	219	1,185	11,480
Total cash provided from (used for) investment activities.....	3,168	(36,141)	219	(10,994)	(43,748)
Net increase (decrease) in cash and cash equivalents.....	141,513	10,930	18,500	(7,718)	163,225
Cash and cash equivalents at July 1, as restated.....	25,232	211,033	—	51,957	288,222
Cash and cash equivalents at June 30.....	\$ 166,745	\$ 221,963	\$ 18,500	\$ 44,239	\$ 451,447

The accompanying Notes to the Financial Statements are an integral part of this statement.

Governmental
Activities —
Internal
Service
Funds

\$ 49,811
—
208,308
(166,632)
(45,012)
(1,169)
(11,157)
133
34,282

—
—
—
—
2,501
(160)
—

2,341

(32,763)
2,173

—
—
—
—

132

(30,458)

—
—
—
—
—
—
916

916

7,081
56,719

\$ 63,800

STATEMENT OF CASH FLOWS PROPRIETARY FUNDS

For the Fiscal Year Ended June 30, 2006

(Dollars in Thousands)

	Business-type Activities — Enterprise Funds				
	Unemployment Compensation Fund	EPA Revolving Loan Fund	N.C. State Lottery Fund	Other Enterprise Funds	Total Enterprise Funds
Reconciliation of Operating Income to Net Cash Provided From (Used For) Operating Activities:					
Operating income (loss).....	\$ 252,998	\$ 10,933	\$ 64,217	\$ 6,055	\$ 334,203
Adjustments to reconcile operating income to net cash flows from operating activities:					
Depreciation/amortization.....	—	21	76	2,983	3,080
Interest earnings on loans classified as investing activity.....	—	(12,609)	—	—	(12,609)
Restatements and adjustments to cash.....	—	—	—	45	45
Nonoperating miscellaneous income (expense).....	—	—	—	13	13
(Increases) decreases in assets:					
Receivables.....	3,848	—	(10,047)	(2,853)	(9,052)
Due from other funds.....	63	—	—	1	64
Due from fiduciary funds.....	—	—	—	—	—
Due from component units.....	—	—	—	—	—
Inventories.....	—	—	—	74	74
Prepaid items.....	—	—	—	(483)	(483)
Increases (decreases) in liabilities:					
Accounts payable and accrued liabilities.....	3,574	37	15,206	741	19,558
Due to other funds.....	—	(1)	78	10	87
Unemployment benefits payable.....	(3,507)	—	—	—	(3,507)
Compensated absences.....	—	98	524	693	1,315
Unearned revenue.....	2,228	—	—	85	2,313
Deposits payable.....	—	—	—	(49)	(49)
Total cash provided from (used for) operations.....	<u>\$ 259,204</u>	<u>\$ (1,521)</u>	<u>\$ 70,054</u>	<u>\$ 7,315</u>	<u>\$ 335,052</u>
Noncash Investing, Capital, and Financing Activities:					
Noncash distributions from the State Treasurer					
Long-Term Investment Portfolio and/or other agents.....	\$ —	\$ —	\$ —	\$ 2,361	\$ 2,361
Donated assets (fair market value).....	—	—	—	218	218
Transferred assets.....	—	—	—	68	68
Assets acquired through the assumption of a liability.....	12,738	190,362	16,064	47,616	266,780
Change in fair value of investments.....	—	—	—	(3,270)	(3,270)

Governmental
Activities —
Internal
Service
Funds

\$ 6,413

26,986

—

(3,367)

2

7,327

(179)

(24)

52

(125)

1,744

(8,390)

(346)

—

532

3,657

—

\$ 34,282

\$ (1,143)

—

—

39,109

(1,710)

STATEMENT OF FIDUCIARY NET ASSETS

FIDUCIARY FUNDS

June 30, 2006

Exhibit B-6

(Dollars in Thousands)

	Pension and Other Employee Benefit Trust Funds	Investment Trust Fund	Private- Purpose Trust Funds	Agency Funds
Assets				
Cash and cash equivalents (Note 3).....	\$ 487,827	\$ 6,655	\$ 97,714	\$ 2,543,046
Investments (Note 3):				
Annuity contracts.....	923,867	—	—	—
U.S. government securities.....	—	—	1,564	—
State and municipal securities.....	—	—	99	—
Corporate bonds.....	—	—	—	50,827
Corporate stocks.....	—	—	—	1,008
Mutual funds.....	3,058,476	—	—	—
Certificates of deposit.....	—	—	65,497	467
State Treasurer investment pool.....	68,334,472	192,963	—	38,477
Securities lending collateral (Note 3).....	14,134,334	147,199	676	1,737,212
Receivables:				
Taxes receivable.....	—	—	—	200,000
Accounts receivable.....	35,402	—	—	3,224
Intergovernmental receivables.....	13,050	—	—	—
Interest receivable.....	2,278	1,214	2	288
Contributions receivable.....	113,133	—	—	—
Due from other funds (Note 9).....	29,717	—	—	12,871
Notes receivable.....	159,644	—	—	—
Inventories.....	—	—	—	301
Sureties.....	—	—	988,443	86,901
Capital assets-depreciable, net.....	29	—	—	—
Total Assets.....	87,292,229	348,031	1,153,995	4,674,622
Liabilities				
Accounts payable and accrued liabilities:				
Accounts payable.....	8,985	—	—	941
Intergovernmental payables.....	—	—	—	639,233
Benefits payable.....	328,408	—	—	—
Medical claims payable.....	170,465	—	—	—
Obligations under securities lending.....	14,134,334	147,199	676	1,737,212
Due to other funds (Note 9).....	28	—	—	—
Unearned revenue.....	6,312	—	—	—
Deposits payable.....	—	—	—	1,682
Funds held for others.....	—	—	—	2,295,554
Compensated absences.....	119	—	—	—
Total Liabilities.....	14,648,651	147,199	676	4,674,622
Net Assets				
Held in trust for:				
Employees' pension and other benefits.....	72,643,578	—	—	—
Pool participants.....	—	200,832	—	—
Individuals, organizations and other governments.....	—	—	1,153,319	—
Total Net Assets.....	\$ 72,643,578	\$ 200,832	\$ 1,153,319	\$ —

The accompanying Notes to the Financial Statements are an integral part of this statement.

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS

FIDUCIARY FUNDS

For the Fiscal Year Ended June 30, 2006
(Dollars in Thousands)

Exhibit B-7

	Pension and Other Employee Benefit Trust Funds	Investment Trust Fund	Private- Purpose Trust Funds
Additions:			
Contributions:			
Employer.....	\$ 2,833,809	\$ —	\$ —
Members.....	1,584,177	—	—
Trustee deposits.....	—	—	137,724
Other contributions.....	47,399	—	—
Total contributions.....	4,465,385	—	137,724
Investment income:			
Investment earnings (loss).....	5,632,740	21,724	3,210
Less investment expenses.....	(696,292)	(10,917)	(26)
Net investment income (loss).....	4,936,448	10,807	3,184
Pool share transactions:			
Reinvestment of dividends.....	—	10,807	—
Net share purchases/(redemptions).....	—	(273,118)	—
Net pool share transactions.....	—	(262,311)	—
Other additions:			
Fees, licenses and fines.....	4,793	—	—
Interest earnings on loans.....	7,912	—	—
Miscellaneous.....	1,898	—	—
Total other additions.....	14,603	—	—
Total additions.....	9,416,436	(251,504)	140,908
Deductions:			
Claims and benefits.....	5,189,664	—	—
Medical insurance premiums for retirees.....	411,760	—	—
Refund of contributions.....	142,263	—	—
Distributions paid and payable.....	—	10,807	—
Payments in accordance with trust arrangements.....	—	—	114,845
Administrative expenses.....	96,765	—	6
Other deductions.....	173	—	—
Total deductions.....	5,840,625	10,807	114,851
Change in net assets.....	3,575,811	(262,311)	26,057
Net assets — July 1.....	69,067,767	463,143	1,127,262
Net assets — June 30.....	\$ 72,643,578	\$ 200,832	\$ 1,153,319

The accompanying Notes to the Financial Statements are an integral part of this statement.

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NOTES TO THE FINANCIAL STATEMENTS

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Financial Reporting Entity

The accompanying government-wide financial statements present the State of North Carolina and its component units. The State of North Carolina, as primary government, consists of all organizations that make up its legal entity. All funds, organizations, agencies, boards, commissions, and authorities that are not legally separate are, for financial reporting purposes, part of the primary government. The primary government has a separately elected governing body (the General Assembly) and the primary government must be both legally separate and fiscally independent. Component units are legally separate entities for which the State is financially accountable. Accountability is defined as the State's substantive appointment of a majority of the component unit's governing board. Furthermore, to be financially accountable, the State must be able to impose its will upon the component unit or there must be a possibility that the component unit may provide specific financial benefits to, or impose specific financial burdens on, the State. Financial accountability also exists when an organization is fiscally dependent upon the State. The State's defined benefit pension plans, deferred compensation plans, and other employee benefit plans, being fiduciary in nature, were not evaluated as potential component units but instead are reported as fiduciary funds.

The State's component units are either blended or discretely presented. The blended component unit is so intertwined with the State that it is, in substance, the same as the State and, therefore, is reported as if it was part of the State primary government. The "Component Units" column in the accompanying financial statements includes the financial data of the State's discretely presented component units. They are combined and reported in a separate column in the government-wide financial statements to emphasize their legal separateness from the State.

Blended Component Unit**The North Carolina Infrastructure Finance Corporation**

The North Carolina Infrastructure Finance Corporation (Corporation) was created by the General Assembly and organized as a separate not-for-profit corporation. It is managed by a three-member board appointed by the State Treasurer. The Corporation is authorized to issue tax-exempt debt to finance the acquisition, construction, repair and renovation of State facilities and related infrastructure. The debt obligations are secured by lease-purchase agreements or installment financing contracts with the State, which constitute the imposition of a financial burden on the State. The substance of the financing agreements is that the assets and debt are those of the State (lessee). The Corporation is reported with the State's governmental funds since it provides services entirely to the State.

Discretely Presented Component Units - Major**The Golden LEAF (Long-term Economic Advancement Foundation), Inc.**

The Golden LEAF, Inc. (Foundation) is a legally separate not-for-profit corporation ordered to be created by the Consent Decree and Final Judgment in the State of North Carolina vs. Philip Morris, et al. The Foundation was established to receive and distribute fifty percent of the tobacco settlement funds allocated to North Carolina, such funds to be used to provide economic impact assistance to economically affected or tobacco-dependent regions of North Carolina. The Foundation is governed by a fifteen-member board, all of whom are appointed by either the Governor, President Pro Tempore of the Senate, or the Speaker of the House. The State assigned fifty percent of its share of the settlement to the Foundation, creating a financial benefit/burden relationship.

University of North Carolina System

The Board of Governors of the consolidated University of North Carolina (UNC) System is a legally separate body, composed of thirty-two members elected by the General Assembly. The Board of Governors establishes system-wide administrative policies while budgetary decisions are exercised at the State level. Within the consolidated System are UNC-General Administration, which is the administrative arm of the Board of Governors; the sixteen constituent universities; and the University of North Carolina Health Care System (UNCHCS). Each of the sixteen universities, in turn, is governed by its own separate board of trustees that is responsible for the operations of that campus only. UNCHCS is governed by a separate board of directors. Funding for the UNC System is accomplished by State appropriations, tuition and fees, sales and services, federal grants, state grants, and private donations and grants.

Also included in the System are the financial data of the universities' significant fund-raising foundations (and similarly affiliated organizations). Although the universities do not control the timing or amount of receipts from their foundations, the majority of resources (or income thereon) that the foundations hold and invest are restricted to the activities of the respective universities by the donors. Because these restricted resources held by the foundations can only be used by, or for the benefit of, the specific universities, the foundations are considered component units of the universities and are included in the universities' financial statements. The foundations are private not-for-profit organizations that report under Financial Accounting Standards Board pronouncements. As such, certain revenue recognition criteria and presentation features are different from that of the Governmental Accounting Standards Board. The foundations' financial statement formats were modified to make them compatible with the universities' financial statement formats.

NOTES TO THE FINANCIAL STATEMENTS

The following constituent institutions comprise the UNC System for financial reporting purposes:

UNC General Administration
 Appalachian State University
 East Carolina University
 Elizabeth City State University
 Fayetteville State University
 North Carolina Agricultural and Technical State University
 North Carolina Central University
 North Carolina School of the Arts
 North Carolina State University
 University of North Carolina at Asheville
 University of North Carolina at Chapel Hill
 University of North Carolina at Charlotte
 University of North Carolina at Greensboro
 University of North Carolina at Pembroke
 University of North Carolina at Wilmington
 Western Carolina University
 Winston-Salem State University
 University of North Carolina Health Care System

Community Colleges

There are currently 58 community colleges located throughout the State of North Carolina. Each is a separate component unit of the reporting entity and is legally separate. The State does not appoint a voting majority of each community college board of trustees. However, the State is financially accountable for these institutions because the State Board of Community Colleges (the Board) approves the budgeting of state and federal funds, the associated budget revisions, and the selection of the chief administrative officer of each individual community college. The Board is comprised of state officials or their appointees. Each community college is similar in nature and function to all of the others, and the operations of no single community college are considered major in relation to the operations of all community colleges in the system. Therefore, aggregated financial information is presented in this CAFR for all community colleges.

The aggregated financial information for community colleges also includes the financial data of the institutions' significant fund-raising foundations. Although the community colleges do not control the timing or amount of receipts from their foundations, the majority of resources (or income thereon) that the foundations hold and invest are restricted to the activities of the respective community colleges by the donors. Because these restricted resources held by the foundations can only be used by, or for the benefit of, the specific community colleges, the foundations are considered component units of the community colleges and are included in the community colleges' financial statements. The foundations are private not-for-profit organizations that report under Financial Accounting Standards Board pronouncements. As such, certain revenue recognition criteria and presentation features are different from that of the Governmental Accounting Standards Board. The foundations' financial statement formats were modified to make them compatible with the community colleges' financial statement formats.

The following are the State's 58 community colleges:

Alamance Comm. College	Asheville-Buncombe Technical Comm. College
Beaufort County Comm. College	Bladen Community College
Blue Ridge Comm. College	Brunswick Comm. College
Caldwell Comm. College and Tech. Institute	Cape Fear Comm. College
Carteret Comm. College	Catawba Valley Comm. College
Central Carolina Comm. College	Central Piedmont Comm. College
Cleveland Comm. College	Coastal Carolina Comm. College
College of The Albemarle	Craven Comm. College
Davidson County Comm. College	Durham Technical Comm. College
Edgecombe Comm. College	Fayetteville Technical Comm. College
Forsyth Technical Comm. College	Gaston College
Guilford Technical Comm. College	Halifax Comm. College
Haywood Comm. College	Isothermal Comm. College
James Sprunt Comm. College	Johnston Comm. College
Lenoir Comm. College	Martin Comm. College
Mayland Comm. College	McDowell Technical Comm. College
Mitchell Comm. College	Montgomery Comm. College
Nash Comm. College	Pamlico Comm. College
Piedmont Comm. College	Pitt Comm. College
Randolph Comm. College	Richmond Comm. College
Roanoke-Chowan Comm. College	Robeson Comm. College
Rockingham Comm. College	Rowan-Cabarrus Comm. College
Sampson Comm. College	Sandhills Comm. College
South Piedmont Comm. College	Southeastern Comm. College
Southwestern Comm. College	Stanly Comm. College
Surry Comm. College	Tri-County Comm. College
Vance-Granville Comm. College	Wake Technical Comm. College
Wayne Comm. College	Western Piedmont Comm. College
Wilkes Comm. College	Wilson Technical Comm. College

North Carolina Housing Finance Agency

The North Carolina Housing Finance Agency is a legally separate organization established to administer programs to finance construction of low and moderate income housing. The Agency has a thirteen-member board of directors, with twelve appointed by either the Governor or the General Assembly. The thirteenth member is elected by the other twelve. The State has the ability to impose its will since it can significantly influence the programs, projects, activities, and level of services of the Agency.

State Education Assistance Authority

The State Education Assistance Authority is a legally separate authority created to provide a system of financial assistance, consisting of grants, loans, work-study or other employment, and other aids, to qualified students to obtain an education beyond the high school level by attending public or private educational institutions. The Authority is governed by a seven-member board of directors, all of whom are appointed by the Governor. The State provides significant operating subsidies to the Authority; therefore, a financial benefit/burden relationship exists between the State and the Authority.

NOTES TO THE FINANCIAL STATEMENTS
Discretely Presented Component Units - Other**North Carolina Phase II Tobacco Certification Entity, Inc.**

The North Carolina Phase II Tobacco Certification Entity, Inc. (Entity) is a legally separate organization established to serve as the certification entity for the State for the National Tobacco Grower Settlement Trust. Under the settlement, tobacco companies agreed to create a trust fund for tobacco growers and quota holders in 14 grower states, including North Carolina. The Entity is governed by a fourteen-member board. Three members serve by virtue of their positions as state officials and nine members are appointed by either the Governor, President Pro Tempore of the Senate, or the Speaker of the House. The State has the ability to impose its will since appointed members may be removed without cause. The Tobacco Buyout Bill enacted in October 2004 ended the trust agreement that the Entity was formed to oversee. The Entity made a final payment to quota and tobacco owners in late 2005. Management believes that it will take approximately two years from the date of final payment to finalize any outstanding issues related to open payment years and to cease operations.

North Carolina Global TransPark Authority

The North Carolina Global TransPark Authority (formerly North Carolina Air Cargo Airport Authority) is a legally separate authority created to administer the development of the North Carolina Global TransPark. Of the twenty-member governing board, nineteen are voting members. Seven of the voting members are appointed by the Governor and six are appointed by the General Assembly. The State has obligated itself to provide significant funding to the Authority; therefore, a financial benefit/ burden relationship exists between the State and the Authority. Also included in the Authority are the financial data of its blended component unit, the North Carolina Global TransPark Foundation (Foundation). The Authority appoints a majority of the Foundation's governing board and receives financial benefits from the Foundation.

North Carolina State Ports Authority

The North Carolina State Ports Authority is a legally separate authority established to operate the State's port facilities in Wilmington and Morehead City. It is governed by an eleven-member board, all of whom are appointed by either the Governor or the General Assembly. The State has obligated itself to provide significant funding to the Authority; therefore, a financial benefit/burden relationship exists between the State and the Authority.

North Carolina Railroad Company

The North Carolina Railroad Company is a legally separate, for-profit corporation owned by the State for the purpose of promoting trade, industry, and transportation within North Carolina and advancing the economic interests of the State. The Railroad is governed by a fourteen member board, all of whom are elected by shares held by the State. A financial benefit/burden relationship exists between the State and the Railroad. Also, the State is financially accountable since the State's intent in owning the Railroad's stock is to directly enhance its ability to provide governmental services.

North Carolina Agricultural Finance Authority

The North Carolina Agricultural Finance Authority is a legally separate authority created to administer the financing of low-interest loans to farmers. The Authority is governed by a ten-member board, one of whom is a state official and nine of whom are appointed by either the Governor or the General Assembly. A financial benefit/burden relationship exists between the State and the Authority.

North Carolina Partnership for Children, Inc.

The North Carolina Partnership for Children, Inc. is a legally separate organization established to develop a comprehensive long-range strategic plan for early childhood development. A twenty-six-member board governs the Partnership. Certain elected state officials appoint twenty-two of the members, while four members serve ex officio by virtue of their state positions. The State provides significant operating subsidies to the Partnership creating a financial benefit/burden relationship.

Regional Economic Development Commissions:**Northeastern North Carolina Regional Economic Development Commission**

The Northeastern North Carolina Regional Economic Development Commission is a legally separate organization created to facilitate economic development and tourism in northeastern North Carolina. The Commission consists of seventeen members, including the Secretary of Commerce and the Secretary of the Department of Environment and Natural Resources (or their designees), five members appointed by the Governor, five by the Speaker of the House, and five by the President Pro Tempore of the Senate. The State provides significant program and operating support to the Commission, creating a benefit/burden relationship.

Southeastern North Carolina Regional Economic Development Commission

The Southeastern North Carolina Regional Economic Development Commission is a legally separate organization created to build economic strength in southeastern North Carolina. The Commission consists of fifteen members, with three appointed by the Governor, two by the Lieutenant Governor, five by the Speaker of the House, and five by the President Pro Tempore of the Senate. The State provides significant program and operating support to the Commission, creating a benefit/burden relationship.

Western North Carolina Regional Economic Development Commission

The Western North Carolina Regional Economic Development Commission is a legally separate organization created to improve economic opportunity in western North Carolina with sensitivity to the resources of that region. The Commission consists of fifteen members, with five appointed by the N.C. House of Representatives, five by the N.C. Senate, three by the Governor, and two by the Lieutenant Governor. The State provides significant program and operating support to the Commission, creating a benefit/burden relationship.

NOTES TO THE FINANCIAL STATEMENTS

North Carolina Turnpike Authority

The North Carolina Turnpike Authority was created to study, design, plan, construct, finance, and operate a system of toll roads, bridges, and/or tunnels supplementing the traditional non-toll transportation system serving the citizens of the State. The Turnpike Authority is governed by a nine member board consisting of four members appointed by the General Assembly, four members appointed by the Governor, and the Secretary of Transportation. The State has the ability to impose its will since appointed members may be removed without cause.

Availability of Financial Statements

Complete financial statements for the following component units can be obtained from the Office of the State Auditor, 2 South Salisbury Street, 20601 Mail Service Center, Raleigh, N.C. 27699-0601.

Constituent institutions in the UNC System
Community colleges
North Carolina Turnpike Authority
North Carolina State Ports Authority
North Carolina Partnership for Children, Inc.
North Carolina Agricultural Finance Authority
North Carolina Global Transpark Authority

Complete financial statements for the following component units can be obtained from the respective administrative offices of those units listed below:

The Golden LEAF, Inc. 107 SE Main Street Rocky Mount, NC 27801	N.C. Housing Finance Agency P.O. Box 28066 Raleigh, N.C. 27611-8066
State Education Assistance Authority P.O. Box 2688 Chapel Hill, N.C. 27515-2688	North Carolina Railroad Company 2809 Highwoods Boulevard, Suite 100 Raleigh, NC 27604-1000
N.C. Phase II Tobacco Certification Entity, Inc. 3125 Poplarwood Ct., Suite 112 Raleigh, N.C. 27604	Northeastern N.C. Regional Economic Development Commission 119 West Water Street Edenton, N.C. 27932
Southeastern N.C. Regional Economic Development Commission P.O. Box 2556 Elizabethtown, N.C. 28337	Western N.C. Regional Economic Development Commission 3 General Aviation Dr. Fletcher, N.C. 28732

The North Carolina Infrastructure Finance Corporation does not issue separate financial statements.

B. Basis of Presentation

The accompanying financial statements of the State of North Carolina financial reporting entity have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") as applicable to governments. The Governmental Accounting Standards Board (GASB) establishes standards of financial accounting and reporting for state and local governmental entities. Private sector standards of accounting and financial reporting issued on or before November 30, 1989 generally are followed in both the government-wide and proprietary fund financial statements to the extent those pronouncements do not conflict with or contradict GASB pronouncements. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The State has elected not to follow subsequent private-sector guidance. The financial statements of the North Carolina Railroad Company (Railroad), a for-profit corporation (discretely presented component unit), have been prepared in accordance with FASB pronouncements.

The financial statements are presented as of and for the fiscal year ended June 30, 2006, except for the USS North Carolina Battleship Commission whose statements are as of and for the fiscal year ended September 30, 2005, and the North Carolina Deferred Compensation Plan, the 401(k) Supplemental Retirement Income Plan, and the North Carolina Railroad Company whose statements are as of and for the fiscal year ended December 31, 2005.

The basic financial statements include both government-wide (based on the State as a whole) and fund financial statements as follows:

Government-wide Financial Statements

The statement of net assets and the statement of activities display information on all the nonfiduciary activities of the primary government (the State) and its component units. Fiduciary activities are excluded from the government-wide statements because they cannot be used to support the State's own programs. As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are interfund services provided and used between functions. Elimination of these charges would misstate both the expenses of the purchasing function and the program revenues of the selling function. These statements distinguish between the governmental and business-type activities of the State. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange transactions. Business-type activities are financed in whole or in part by fees charged to external parties. Likewise, the primary government is reported separately from certain legally separate component units for which the primary government is financially accountable.

NOTES TO THE FINANCIAL STATEMENTS

The statement of activities demonstrates the degree to which the direct expenses of a given function or identifiable activity are offset by program revenues. Direct expenses are those that are clearly associated with a specific function or identifiable activity. Certain charges to other funds or programs for "centralized" expenses also include an overhead markup that is included in direct expenses. Program revenues include (a) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or identifiable activity (including fees, fines and forfeitures and certain grants and contracts that are essentially contracts for services) and (b) grants and contributions that are restricted to meeting the operational or capital requirements of a particular program or identifiable activity (including restricted investment earnings or losses). Revenues that are not classified as program revenues, including all taxes, are presented as general revenues. Unrestricted resources internally dedicated by the State's governing body (General Assembly) are reported as general revenues rather than as program revenues. The State does not allocate general government (indirect) expenses to other functions.

Fund Financial Statements

The fund financial statements provide information about the State's funds, including its fiduciary funds. Separate statements for each fund category—governmental, proprietary, and fiduciary—are presented. The emphasis of fund financial statements is on major governmental and major enterprise funds, each displayed in a separate column. All remaining governmental and enterprise funds are aggregated and reported as nonmajor funds.

The State reports the following major governmental funds:

General Fund

This is the State's primary operating fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund.

Highway Fund

This fund accounts for most of the activities of the Department of Transportation, including the construction and maintenance of the State's primary and secondary road systems. In addition, it supports areas such as the N.C. Ferry System, the Division of Motor Vehicles, public transportation, and railroad operations. The fund provides revenue to other State agencies to support initiatives such as the State Highway Patrol and driver's education. The principal revenues of the Highway Fund are motor fuels taxes, motor vehicle registration fees, driver's license fees, and federal aid. A portion of the motor fuels taxes is distributed to municipalities for local street projects.

Highway Trust Fund

This fund was established by legislation (Chapter 692 of the 1989 Session Laws) to provide a dedicated funding mechanism to meet highway construction needs for North Carolina. Taxes were increased for the specific purpose of improving identified primary transportation corridors within

the State and for the completion of urban loops around seven major metropolitan areas. Additionally, this fund provides supplemental allocations for secondary road construction and supplemental assistance to municipalities for local street projects. The fund also makes transfers to the General Fund and the Highway Fund. The principal revenues of the Highway Trust Fund are highway use taxes, motor fuels taxes, and various title and registration fees.

The State reports the following major enterprise funds:

Unemployment Compensation Fund

This fund accounts for the State's unemployment insurance program, which is part of a national system established to provide temporary benefit payments to eligible unemployed workers. The unemployment benefits are financed primarily by State unemployment insurance taxes, distributions of federal unemployment insurance taxes, and federal funding for the unemployment benefits of civilian and military employees. The unemployment taxes collected from employers are transferred to the United States Treasury and deposited into North Carolina's Unemployment Insurance Trust Fund.

N.C. State Lottery Fund

This fund accounts for the activities of the N.C. Education Lottery Commission, which began ticket sales on March 30, 2006. The net profits of the fund are transferred periodically to the Education Lottery Fund, a nonmajor special revenue fund.

EPA Revolving Loan Fund

This fund accounts for the activities of the State's clean water and drinking water revolving loan programs, which provide low cost loans to units of local government for the construction of wastewater facilities and drinking water infrastructure. These programs are financed primarily by federal capitalization grants from the United States Environmental Protection Agency (EPA), interest earnings on loans, loan repayments, and State funds (i.e., bond proceeds and State appropriations).

Additionally, the State reports the following fund types:

Internal Service Funds

These funds account for workers compensation and state property fire insurance coverages, motor fleet management services, mail services, temporary staffing services, computing and telecommunication services, and surplus property services provided to other departments or agencies of the State and its component units, or to other governments, on a cost-reimbursement basis.

Pension and Other Employee Benefits Trust Funds

These funds account for resources held in trust for the members and beneficiaries of the State's defined benefit pension plans, Internal Revenue Code (IRC) Section 401(k) plan, IRC Section 457 plan, other defined contribution plans, death benefit plan, disability income plan, State health plan, and retiree health benefit fund.

NOTES TO THE FINANCIAL STATEMENTS

Investment Trust Fund

This fund accounts for the external portion of the Investment Pool sponsored by the Department of State Treasurer.

Private-purpose Trust Funds

These funds account for resources held in trust for insurance carriers, designated beneficiaries by the Administrative Office of the Courts, and other departmental trust funds in which the principal and income benefit individuals, private organizations, or other governments.

Agency Funds

These funds account for sales tax collections held on behalf of local governments, resources held by the Administrative Office of the Courts for distribution to designated beneficiaries, the Investment Pool's securities lending assets and liabilities allocated to participating component units, insurance company receivership assets, and other resources held by the State in a purely custodial capacity for individuals, private organizations, or other governments. Insurance company receivership assets are held by the Commissioner of Insurance exclusively in his capacity as Receiver. These assets belong to insurance companies and other entities in receivership and are not the property of the State.

C. Measurement Focus and Basis of Accounting

Government-wide, Proprietary, and Fiduciary Fund Financial Statements

The government-wide, proprietary, and fiduciary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, except for agency funds which do not have a measurement focus. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of related cash flows.

Lottery games are sold to the public by contracted retailers. For Powerball, revenue is recognized at the time of sale. For instant games, revenue is recognized at the time a pack of tickets is settled. For Powerball, prize expense is recorded at fifty percent of sales. For instant games, prize expense is accrued based on the final production prize structure percentage provided by the gaming vendor for each game and recorded on the value of packs settled. For instant games with prize tickets, the final prize structure percentage used is adjusted to eliminate the value of the prize tickets.

Nonexchange transactions, in which the State receives (or gives) value without directly giving (or receiving) equal value in exchange, include taxes; fines and forfeitures; grants, entitlements, and similar items; and donations. Recognition standards are based on the characteristics and classes of nonexchange transactions. Income taxes, sales taxes, and other

similar taxes on earnings or consumption are recognized as revenues, net of estimated refunds and uncollectible amounts, in the accounting period when the underlying exchange transaction has occurred. Franchise taxes, other taxes, and fines and forfeitures are recognized as revenues, net of estimated refunds and uncollectible amounts, in the accounting period when an enforceable legal claim to the assets arises and the use of resources is required or is first permitted. Grants, entitlements, and donations are recognized as revenues, net of estimated uncollectible amounts, as soon as all eligibility requirements imposed by the provider have been met, if probable of collection. Amounts received before all eligibility requirements have been met are reported as deferred revenues. Grants and similar aid to other organizations are recognized as expenses as soon as recipients have met all eligibility requirements. Amounts paid before all eligibility requirements have been met are reported as prepaid items.

Governmental Fund Financial Statements

Governmental funds are reported using the current financial resources measurement focus and the modified accrual basis of accounting. With this measurement focus, only current assets and liabilities are generally included on the balance sheet. The operating statement presents increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in spendable resources. General capital asset acquisitions are reported as expenditures and proceeds of general long-term debt are reported as other financing sources.

Under the modified accrual basis of accounting, revenues are recognized when both measurable and available. Generally, the State considers revenues reported in the governmental funds to be available if they are collected with thirty-one days after year-end. Exceptions are individual income tax revenues and federal and county funds accrued for the matching share of medicaid claims payable, which the State considers to be available if they are collected within twelve months after year-end. Furthermore, in the circumstance where underpayments exceed overpayments, individual income tax revenues are recognized to the extent of estimated overpayments (i.e., refunds payable and applied refunds). Principal revenue sources considered susceptible to accrual include taxes, federal funds, local funds, and investment earnings. Other revenues are considered to be measurable and available only when cash is received by the State.

Expenditures are recorded when the related fund liability is incurred, except for principal and interest on general long-term debt, claims and judgments, compensated absences, obligations for workers' compensation, and arbitrage rebate liabilities, which are recognized as expenditures when payment is due. Pension contributions to cost-sharing pension plans are recognized as expenditures in the period to which the payment relates, even if payment is not due until the subsequent period.

NOTES TO THE FINANCIAL STATEMENTS
D. Cash and Cash Equivalents

This classification includes undeposited receipts; petty cash; deposits held by the State Treasurer in the Short-term Investment portfolio (see Note 3); and demand and time deposits with private financial institutions, excluding certificates of deposit. The Short-term Investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit additional cash at any time and also may withdraw cash at any time without prior notice or penalty.

E. Investments

This classification includes deposits held by the State Treasurer in certain long-term investment portfolios (see Note 3) as well as investments held separately by the State and its component units. Investments are generally reported at fair value. Additional investment valuation information is provided in Note 3. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

F. Securities Lending

Cash and securities received as collateral on securities lending transactions are reported as assets in the accompanying financial statements. Liabilities resulting from the securities lending transactions are also reported. Certain component units of the State deposit funds with the State Treasurer's Investment Pool, which participates in securities lending activities. The component units' position in the pool and related securities lending assets and liabilities are reported in an agency fund. Additional disclosures about the State Treasurer's securities lending transactions are provided in Note 3.

G. Receivables and Payables

Receivables in all funds represent amounts that have arisen in the ordinary course of business and are shown net of allowances for uncollectible amounts.

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/due from other funds" (i.e., current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds related to services provided and used, reimbursements, and transfers are classified as "due to/due from other funds." Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as "internal balances."

In the fund financial statements, advances between funds (and to component units) and notes receivable are offset by a reserve account in applicable governmental funds to indicate

that they are not available for appropriation and are not expendable available financial resources.

H. Inventories and Prepaid Items

The inventories of the State and component units are valued at cost using either the first-in, first-out, last invoice cost, or average cost method. These inventories consist of general supplies and materials. Institutions of the UNC system and community colleges also use these valuations along with the retail inventory method for some bookstore operations. The State Highway Fund (special revenue fund) accounts for its maintenance and construction inventories using the average cost method.

Except for maintenance and construction inventories of the State Highway Fund, inventories in the State's governmental funds are recorded as expenditures when purchased. In the fund financial statements, inventories are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources. All other inventories of the State and its component units are recognized as expenses or expenditures when consumed.

Certain payments to vendors and grantees reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

I. Restricted/Designated Assets

In the enterprise funds, unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. These assets are also classified as noncurrent since they cannot be used for current operations (i.e., are restricted for the acquisition/construction of capital assets). Unrestricted assets that are internally designated for capital purposes are also classified as noncurrent. Certain other assets are classified as restricted because their use is limited by statute.

J. Capital Assets

Capital assets, which include property, plant, equipment; easements; and infrastructure assets (e.g., State highway network, utility systems, and similar items), are reported in the government-wide financial statements and the fund financial statements for proprietary funds. Purchased or constructed capital assets are reported at cost or estimated historical cost. The State highway network constructed prior to July 1, 2001 is recorded at estimated historical cost. Since July 1, 2001 the State highway network is recorded at cost. The initial estimated historical cost of the network is based on construction expenditures reported by the Department of Transportation less amounts estimated for the cost of right-of-ways and land

NOTES TO THE FINANCIAL STATEMENTS

improvements. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend its useful life are not capitalized. Donated capital assets are recorded at their estimated fair value at the date of donation.

Generally, capital assets are defined by the State and component units as assets with an initial value or cost greater than or equal to \$5,000 and an estimated useful life of two or more years. Exceptions are certain component units (The Golden LEAF, Inc., N.C. Housing Finance Agency, N.C. Phase II Tobacco Certification Entity, Inc., N.C. Railroad Company, and N.C. Regional Economic Development Commissions), which maintain minimum thresholds of \$1,000 or below.

The value of assets constructed by the State and its component units for their own use includes all material direct and indirect construction costs that are increased as a result of the construction. In proprietary funds and component units, interest costs incurred (if material) are capitalized during the period of construction.

The depreciation methods and estimated useful lives used by the state and component units are as follows:

<u>Asset Class</u>	<u>Method</u>	<u>Estimated Useful Life</u>
Buildings.....	Straight-line	10-50 years
Machinery and Equipment.....	Straight-line	2-25 years
	Units of output for motor vehicles	90,000 miles
Intangible assets.....	Straight-line	2-40 years
Art, literature, and other artifacts.....	Straight-line	2-25 years
General infrastructure.....	Straight-line	10-75 years
State highway network.....	Composite	50 years

For the State highway network, depreciation is based on a weighted average of the estimated useful lives of dissimilar assets in the network (e.g., subsurface foundations, roadway surfaces, bridges, traffic control devices, guardrails, markings, signage, etc.).

K. Tax Refund Liabilities

Tax refund liabilities consist primarily of accrued income and sales and use tax refunds due to taxpayers. During the calendar year, the State collects employee withholdings and taxpayers' payments for income taxes. At June 30, the State estimates the amount it owes taxpayers for income tax overpayments during the preceding six months. Sales and use tax refund liabilities are also estimated at June 30. These liabilities are recorded as "Tax refunds payable."

L. Compensated Absences

Employees of the State and component units are permitted to accumulate earned but unused vacation pay benefits. All vacation pay is accrued when incurred in the government-wide and proprietary fund financial statements. Also, when determining the vacation pay liability due within one year, leave is considered taken on a last in, first out (LIFO) basis. In governmental funds, a liability for these amounts is reported only as payments come due each period upon the occurrence of relevant events such as employee resignations and retirements. The State's policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at year end is converted to sick leave.

In addition to the vacation leave described above, compensated absences include the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly. The bonus leave balance on December 31 is retained by employees and transferred into the next calendar year. It is not part of the 30 day maximum applicable to regular vacation leave and is not subject to conversion to sick leave.

There is no liability for unpaid accumulated sick leave because the State has no obligation to pay sick leave upon employee termination or retirement. However, additional service credit for retirement pension benefits is given for accumulated sick leave upon retirement.

M. Long-Term Liabilities

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the columns for governmental activities, business-type activities, and component units. These amounts are also reported as liabilities in the fund financial statements for proprietary funds. Debt premiums of the State are deferred and amortized over the life of the debt using the effective interest method, if material. Losses on the State's refundings are deferred and amortized over the remaining life of the old debt or the life of the new debt, whichever is shorter, using the effective interest method. Losses on refundings of the NC Housing Finance Agency are deferred and amortized using the straight-line method. Debt premiums, discounts, and losses on refundings of the University of North Carolina System (component unit) are generally deferred and amortized using the straight-line method, if material. Long-term debt is reported net of the applicable debt premium, discount, and/or deferred loss on refunding. Debt issuance costs of the State's governmental activities and the University of North Carolina System (component unit) are generally expensed. Debt issuance costs of the State's business-type activities and the NC Housing Finance Agency and the NC State Education Assistance Authority (component units) are deferred and amortized over the life of the debt using the straight-line method.

NOTES TO THE FINANCIAL STATEMENTS

Capital appreciation bonds are those bonds that are issued at stated interest rates (which may be zero) significantly below their effective interest rate, resulting in a substantial discount (deep discount). The implicit interest (i.e., discount) is not paid until the bonds mature. Therefore, the net value of the bonds accrete (i.e., the discount is reduced) over the life of the bonds. This deep-discount debt is reported in the government-wide financial statements at its net or accreted value rather than at face value.

In the fund financial statements, governmental fund types recognize debt premiums, as well as debt issuance costs, during the current period. The face amount of the debt issued and premiums received are reported as other financing sources. Issuance costs, whether or not withheld from the actual proceeds received, are reported as debt service expenditures.

N. Sureties

Sureties include various assets, including securities from insurance companies and bail bondsmen doing business within North Carolina, that have been placed in safekeeping with a financial institution or the State Treasurer, as required by applicable general statutes.

O. Net Assets/Fund Balance

Net assets are reported as restricted when constraints placed on them are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or are imposed by law through constitutional provisions. Constraints placed on net asset use by enabling legislation are not reported as net asset restrictions since such constraints are not legally enforceable. An Attorney General Advisory Opinion referenced that the Governor, pursuant to his constitutional authority under Article III, Section 5(3), may use resources restricted by enabling legislation in his discretion to meet a budget shortfall. Legal enforceability means that the State can be compelled by an external party, such as citizens, public interest groups, or the judiciary to use resources created by enabling legislation only for the purposes specified by the legislation. Situations where the State's internal governing body (General Assembly) places restrictions on existing resources or earmarks existing revenue sources are considered to be constraints that are internally imposed. Such internally dedicated net assets are presented as unrestricted.

Under some programs, the State has the option of using either restricted or unrestricted resources to make certain payments. When both restricted and unrestricted resources are available for use, generally it is the State's policy to use receipts first (which include restricted and unrestricted resources), then State appropriations as necessary. Receipts are defined as all funds collected by an agency or institution other than State appropriations. The decision to use restricted or unrestricted receipts to fund a payment is transactional-based within the departmental management system in place at the agency or

institution. For projects funded by tax-exempt debt proceeds and other sources, the debt proceeds are always used first.

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are (a) externally restricted for a specific use, (b) not available for appropriation or expenditure because the underlying asset is not an available financial resource, or (c) for encumbrances, which represent commitments related to unperformed contracts for services and undelivered goods. Designations of fund balance represent tentative management plans that are subject to change (See Note 10, Fund Balance Reserves).

P. Revenues and Expenses

Proprietary funds distinguish operating revenues and expenses from nonoperating items and capital contributions. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. Proprietary fund operating revenues result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as noncapital grants and investment earnings, result from nonexchange transactions or ancillary activities. Capital contributions are reported separately, after nonoperating revenues and expenses.

Q. Food Stamps

In accordance with GASB Statement No. 24, Accounting and Financial Reporting for Certain Grants and Other Financial Assistance, the State recognizes distributions of food stamp benefits as revenue and expenditures in the general fund, whether the benefits are distributed directly or through agents and whether the benefits are in paper or electronic form. Expenditures are recognized when the benefits are distributed to the individual recipients by the State or its agents; revenue is recognized at the same time. Revenue, expenditures, and balances of food stamps are measured based on face value.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 2: STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Fund Balance / Net Assets Deficit**Component Unit**

At June 30, 2006, the following component unit reported a net assets deficit: N. C. Turnpike Authority, \$3.915 million.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 3: DEPOSITS AND INVESTMENTS

A. Deposits and Investments with State Treasurer

Unless specifically exempt, every agency of the State and certain component units are required by General Statute 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. Certain local governmental units that are not part of the reporting entity are also allowed to deposit money with the State Treasurer. Expenditures for the primary government and certain component units are made by warrants issued by the agencies and drawn on the State Treasurer. The State Treasurer processes these warrants each day when presented by the Federal Reserve Bank. General Statute 147-69.1 authorizes the State Treasurer to invest all deposits in obligations of or fully guaranteed by the United States; obligations of certain federal agencies; specified repurchase agreements; obligations of the State of North Carolina; time deposits with specified financial institutions; prime quality commercial paper with specified ratings; specified bills of exchange or time drafts; asset-backed securities with specified ratings; and corporate bonds and notes with specified ratings.

General Statute 147-69.2 authorizes the State Treasurer to invest the deposits of certain special funds, including the pension trust funds, the State Health Plan, the Disability Income Plan of N.C., the Escheats Fund, the Public School Insurance Fund, the State Education Assistance Authority, and trust funds of the University of North Carolina System, in the investments authorized in General Statute 147-69.1; general obligations of other states; general obligations of North Carolina local governments; asset-backed securities bearing specific ratings; and obligations of any company incorporated within or outside the United States bearing specific ratings. The deposits of the pension trust funds may be invested in all of the above plus certain insurance contracts; group trusts; individual, common or collective trusts of banks and trust companies; real estate investment trusts; limited partnership interest in limited liability partnerships or limited liability companies; and certain stocks and mutual funds.

External Investment Pool

To ensure that these and other legal and regulatory limitations are met, all cash deposited with the State Treasurer, except for the UNC Hospitals, Escheat Fund, and bond proceeds investment accounts, is maintained in the Investment Pool. This pool, a governmental external investment pool, consists of the following individual investment portfolios:

Short-term Investment – This portfolio may hold any of the investments authorized by General Statute 147-69.1. The Short-term Investment portfolio is the primary cash management account for the State and is managed in such a manner as to be readily convertible into cash. The

primary participants of this portfolio are the General Fund and the Highway Funds. Other participants include the remaining portfolios listed below, universities and various boards, commissions, community colleges, and school administrative units that make voluntary deposits with the State Treasurer.

Long-term Investment – This portfolio may hold the fixed-income investments authorized by General Statutes 147-69.1 and 147-69.2. Since the deposits in this fund are typically not needed for day-to-day operations, the investment vehicles used generally have a longer term and higher return than those held in the Short-term Investment portfolio. The primary participants of the portfolio are the pension trust funds.

Equity Investment – This portfolio holds an equity-based trust. The State's pension trust funds are the sole participants in the portfolio.

Real Estate Investment – This portfolio holds investments in real estate-based trust funds and group annuity contracts. The State's pension trust funds are the sole participants in the portfolio.

Alternative Investment – This portfolio holds investments in limited partnerships and equities received in the form of distributions from its primary investments. The State's pension trust funds are the sole participants in the portfolio.

All of the above investment portfolios operate like individual investment pools, except that an investment portfolio may hold shares in other investment portfolios at the discretion of the State Treasurer and subject to the legal limitations discussed above. To this extent, the deposits are commingled; and therefore, the State Treasurer considers all investment portfolios to be part of a single pool, the Investment Pool. The Investment Pool contains deposits from funds and component units of the reporting entity (internal portion) as well as deposits from certain legally separate organizations outside the reporting entity (external portion). This pool is not registered with the Securities and Exchange Commission and is not subject to any formal oversight other than that of the legislative body.

At year-end, the condensed financial statements for the Investment Pool maintained by the State Treasurer were as follows (dollars in thousands):

NOTES TO THE FINANCIAL STATEMENTS

Statement of Net Assets
June 30, 2006

Assets:	
Cash and cash equivalents.....	\$ 320,050
Other assets.....	411,008
Investments.....	98,791,063
Total assets.....	<u>99,522,121</u>
Liabilities:	
Distributions payable.....	8,844
Other payables.....	25,000
Obligations under securities lending.....	21,667,015
Total liabilities.....	<u>21,700,859</u>
Net Assets:	
Internal:	
Primary government.....	75,592,566
Component units.....	2,027,864
External.....	200,832
Total net assets.....	<u>\$ 77,821,262</u>

Statement of Operations and Changes in Net Assets
For the Fiscal Year Ended June 30, 2006

Revenues:	
Investment income.....	\$ 5,918,457
Expenses:	
Securities lending.....	853,022
Investment management.....	138,335
Total expenses.....	<u>991,357</u>
Net increase in net assets resulting from operations.....	4,927,100
Distributions to participants:	
Distributions paid and payable.....	(4,927,100)
Share transactions:	
Reinvestment of distributions.....	4,928,231
Net share redemptions.....	<u>(1,439,071)</u>
Total increase in net assets.....	3,489,160
Net assets:	
Beginning of year.....	74,332,102
End of year.....	<u>\$ 77,821,262</u>

The external portion of the Investment Pool is presented in the State's financial statements as an investment trust fund. Each fund and component unit's share of the internal equity in the Investment Pool is reported in the State's financial statements as an asset of those funds or component units. Equity in the Short-term Investment portfolio is reported as cash and cash equivalents while equity in the Long-term Investment, Equity Investment, Real Estate Investment, and Alternative Investment portfolios is reported as investments. The internal equity of the pool differs from the amount of assets reported by the funds and component units due to the typical

banker/customer outstanding and in-transit items. Additionally, each fund reports its share of the assets and liabilities arising from securities lending transactions. The State reports the assets and liabilities arising from securities lending transactions for component units as part of the State's agency funds, rather than allocate them to the component units.

Investments in nonparticipating contracts, such as nonnegotiable certificates of deposit, are reported at cost. Other investments held in the Short-term Investment portfolio are reported at amortized cost, which approximates fair value. All other investments are reported at fair value. Fair values are determined daily for the Long-term Investment and Equity Investment portfolios and quarterly for the Real Estate Investment and Alternative Investment portfolios. The fair value of fixed income securities is based on future principal and interest payments discounted using current yields for similar instruments. Investments in real estate trusts, limited partnerships, and the equity trust are valued using market prices provided by the third party professionals. Participants' shares sold and redeemed are determined in the same manner as is used to report investments, and the State Treasurer does not provide or obtain legally binding guarantees to support share values.

Net investment income earned by the Investment Pool is generally distributed on a pro rata basis. However, in accordance with legal requirements, the General Fund receives all investment income earned by funds created for purposes of meeting appropriations. For the fiscal year ended June 30, 2006, \$50.31 million of investment income associated with other funds was credited to the General Fund.

Deposits

Custodial Credit Risk. For deposits, custodial credit risk is the risk that in the event of a bank failure, the State's deposits may not be recovered. At year-end, the Investment Pool's deposits were not exposed to custodial credit risk.

The State Treasurer's deposit policy for custodial credit risk is limited to complying with the collateralization rules of the North Carolina Administrative Code (Chapter 20 NCAC 7). Deposits to the Investment Pool may be made in any bank, savings and loan association or trust company in the State as approved by the State Treasurer. The North Carolina Administrative Code requires depositories to collateralize all balances that are not insured. The depositories must maintain specified security types in a third party escrow account established by the State Treasurer. The securities collateral must be governmental in origin (e.g., U.S. Treasury, U.S. agency, or state and local government obligations) or the highest grade commercial paper and bankers' acceptances. The market value of the collateral must not be less than the value of the uninsured deposits. The depositories may elect to collateralize deposits separately (dedicated method) or include deposits of the North Carolina local government units in a collateral pool with the State and certain component units (pooling method).

NOTES TO THE FINANCIAL STATEMENTS

Investments

At year-end, the Investment Pool maintained by the State Treasurer had the following investments and maturities (dollars in thousands):

Investment Type	Carrying Amount	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More Than 10
Debt securities:					
U.S. Treasuries	\$ 11,854,576	\$ 3,146,847	\$ 3,067,309	\$ 1,558,319	\$ 4,082,101
U.S. agencies	6,887,071	1,402,136	2,184,900	2,399,668	900,367
Mortgage pass-throughs	6,326,147	—	—	—	6,326,147
Domestic corporate bonds	8,055,999	—	1,022,814	3,993,519	3,039,666
Securities purchased with cash collateral under securities lending program:					
Asset-backed securities	11,764,962	1,991,216	9,773,746	—	—
Repurchase agreements	4,435,041	4,435,041	—	—	—
Domestic corporate bonds	5,467,012	450,271	5,016,741	—	—
	54,790,808	\$ 11,425,511	\$ 21,065,510	\$ 7,951,506	\$ 14,348,281
Other securities:					
Equity based trust - domestic	32,587,628				
Equity based trust - international	7,476,717				
Alternative investments:					
Hedge funds	901,619				
Private equity investment partnerships	574,247				
Stock distributions	4,414				
Real estate trust funds	2,455,630				
Total investment securities	\$ 98,791,063				

Also, the major investment classifications of the Investment Pool had the following attributes at year-end (dollars in thousands):

Investment Classification	Principal Amount	Range of Interest Rates
U.S. Treasuries	\$ 11,075,848	2.25%-8.88%
U.S. agencies	6,966,786	0.0%-7.13%
Mortgage pass-throughs	6,484,376	5.0%-9.0%
Domestic corporate bonds	8,039,308	3.45%-9.8%
Securities purchased with cash collateral under securities lending program:		
Asset-backed securities	11,764,699	5.07%-5.54%
Repurchase agreements	4,435,041	4.67%-5.38%
Domestic corporate bonds	5,467,000	5.02%-5.56%
Equity-based trust - domestic	n/a	n/a
Equity-based trust - international	n/a	n/a

Equity-based Trust - The State Treasurer has contracted with an external party (Trustee) to create the "Treasurer of the State of North Carolina Equity Investment Fund Pooled Trust" (the Trust). The State's pension trust funds are the only depositors in the Trust. The State Treasurer employs investment managers to manage the assets, primarily in equity and equity-based securities in accordance with the General Statutes and parameters provided by the State Treasurer. The Trustee maintains custody of the underlying securities in the name of the Trust, services the securities, and maintains all related accounting records. The Trustee also acts as a securities lending agent for the Trust, invests residual cash in a cash sweep fund, and may be temporarily employed as an investment

manager. The State Treasurer maintains beneficial interest in the Trust and no direct ownership of the securities.

Interest Rate Risk. Although there is no formally adopted investment policy, as a means of managing interest rate risk, fixed income assets of the Short-term Investment portfolio are invested in a laddered maturity approach that focuses on short maturity securities with ample liquidity. The Short-term Investment portfolio had a weighted average maturity of 1.18 years as of June 30, 2006. Most of the cash and cash equivalents of the major governmental and enterprise funds are invested in this portfolio.

NOTES TO THE FINANCIAL STATEMENTS

The assets of the Long-term Investment portfolio are primarily invested in securities with maturities longer than five years. The longer maturity range is more sensitive to interest rate changes; however, the longer duration structure of the portfolio provides a better match to the long duration characteristics of the retirement systems' liabilities. At year-end, pensions and other employee benefit plans owned 98% of the Long-term Investment portfolio and the Escheats Fund (included with other governmental funds) owned 1%.

The Long-term Investment portfolio holds investments in Government National Mortgage Association (GNMA) mortgage pass through pools. Critical to the pricing of these securities are the specific features of the cash flows from the interest and principal payments of the underlying mortgages. Therefore, these valuations are very sensitive to the potential of principal prepayments by mortgagees in periods of declining interest rates. Also, included within the Long-term Investment portfolio are U.S. government agencies and corporate bonds which carry call options in which the issuer has the option to prepay the principal at certain dates over the life of the security. As such, these types of securities are more sensitive to the decline in

long-term interest rates as similar securities without call options.

Credit Risk. General Statute 147-69.1 specifies the cash investment options for the Short-term Investment portfolio. The statute limits credit risk by restricting the portfolio's corporate obligations, asset-backed securities, and commercial paper to securities that bear the highest rating of at least one nationally recognized rating service and do not bear a rating below the highest by any nationally recognized rating service. General Statute 147-69.2 specifies the cash investment options for the Long-term Investment portfolio. The statute limits credit risk by restricting the portfolio's asset-backed securities and corporate obligations to securities that bear one of the four highest ratings of at least one nationally recognized rating service and do not bear a rating below one of the four highest ratings by any nationally recognized rating service. In the Long-term Investment portfolio, all holdings were rated BBB (or equivalent) or higher at the time of purchase by all three nationally recognized rating agencies.

At year-end, the Investment Pool had the following credit quality distribution for securities with credit exposure (dollars in thousands):

Investment Type	Carrying Amount by Credit Rating - Moody's/S&P/Fitch			
	Aaa/AAA	Aa/AA	A	Baa/BBB
U.S. agencies	\$ 6,887,071	\$ —	\$ —	\$ —
Domestic corporate bonds	629,264	2,520,314	3,131,702	1,774,719
Securities purchased with cash collateral under securities lending program:				
Asset-backed securities	11,764,962	—	—	—
Repurchase agreements	4,435,041	—	—	—
Domestic corporate bonds	789,730	1,007,071	3,670,211	—
Total	<u>\$ 24,506,068</u>	<u>\$ 3,527,385</u>	<u>\$ 6,801,913</u>	<u>\$ 1,774,719</u>

Custodial Credit Risk. For an investment, custodial credit risk is the risk that in the event of the failure of the counterparty, the State Treasurer will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. At year-end, the investments purchased with cash collateral under the securities lending program of \$21.67 billion were exposed to custodial credit risk since the securities were held by the counterparty and were not registered in the name of the State Treasurer. As required by contractual agreements, a third party agent holds these assets for the benefit of a dedicated Treasurer's account. This agreement fully indemnifies the Treasurer for any third party defaults or losses. All other investments of the Investment Pool were not exposed to custodial credit risk at year-end and no custodial credit risk policy has been adopted for these investment types.

NOTES TO THE FINANCIAL STATEMENTS

Foreign Currency Risk. At year-end, the Investment Pool's exposure to foreign currency risk was as follows (dollars in thousands):

	Carrying Value by Investment Type				
	Equity Based Trust - International	Investment - Private Equity Investment Partnerships	Real-Estate Trust Fund Investment Partnerships		Total
Currency					
Euro	\$ 2,007,451	\$ 106,052	\$ 41,410	\$	2,154,913
Japanese Yen	1,577,484	2,737	—		1,580,221
Pound Sterling	1,150,973	—	—		1,150,973
Swiss Franc	595,278	—	—		595,278
Hong Kong Dollar	217,273	—	—		217,273
Australian Dollar	189,390	—	—		189,390
New Taiwan Dollar	153,727	—	—		153,727
South Korean Won	138,140	—	—		138,140
Canadian Dollar	127,628	—	—		127,628
Other Currencies	651,449	—	—		651,449
Total	\$ 6,808,793	\$ 108,789	\$ 41,410	\$	6,958,992

Although there is no formally adopted investment policy, the State Treasurer's investment policy permits up to 13% of the retirement systems' invested assets to be in international securities. At year-end, the retirement systems had approximately 10.2% invested in international securities.

Securities Lending

Based on the authority provided in General Statute 147-69.3(e), the State Treasurer lends securities from its Investment Pool to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The Treasurer's securities custodian manages the securities lending program. During the year the custodian lent U.S. government and agency securities, GNMA's, corporate bonds and notes for collateral. The custodian is permitted to receive cash, U.S. government and agency securities, or irrevocable letters of credit as collateral for the securities lent. The collateral is initially pledged at 102% of the market value of the securities lent, and additional collateral is required if its value falls to less than 100% of the market value of the securities lent. There are no restrictions on the amount of loans that can be made. Substantially all security loans can be terminated on demand by either the State Treasurer or the borrower. The State Treasurer cannot pledge or sell the collateral securities received unless the borrower defaults.

The cash collateral received is invested by the custodian agent and held in a separate account in the name of the State Treasurer. The average maturities of the cash collateral investments are less than the average maturities of the securities lent. While cash can be invested in securities ranging from overnight to five years, the custodian agent is not permitted to make investments where the weighted average maturity of all investments exceeds 30 days. At year-end, the weighted average maturity of investments was approximately 22 days.

At year-end, the State Treasurer had no credit risk exposure to borrowers because the amounts the Treasurer owed the borrowers exceeded the amounts the borrowers owed the State. The securities custodian is contractually obligated to indemnify the Treasurer for certain conditions, the two most important are default on the part of the borrowers and failure to maintain the daily mark-to-market on the loans.

Interest rate risk and credit risk. The policies for investments purchased with cash collateral under the securities lending program are set forth in the contract with the securities custodian. Contractually, asset-backed securities must bear the highest rating of at least one nationally recognized rating service. The expected maturity shall not exceed five years and securities having a final maturity greater than two years will be in floating rate instruments with interest rate resets occurring at no greater than 90-day intervals to minimize the effect of interest rate fluctuations on their valuations. The securities pledged as collateral for repurchase agreements are limited to securities issued or guaranteed by the U.S. government or its agencies, or specified bank or corporate obligations. As directed by the State Treasurer, repurchase counterparties are limited to specific counterparties with specific dollar limits per counterparty. Corporate bonds and notes, including bank holding company obligations, rated AA must have a final maturity no greater than three years. Securities rated A must have a final maturity no greater than two years. No more than five percent of the cash collateral may be invested in a single issue.

NOTES TO THE FINANCIAL STATEMENTS**Bond Proceeds Investment Accounts**

The State Treasurer has established separate investment accounts for each State bond issue to comply with Internal Revenue Service regulations on bond arbitrage. A private investment company under contract with the State Treasurer manages these separate accounts. The investments are valued at amortized cost, which approximates fair value. In the State's financial statements, each fund's equity in these accounts is reported as investments.

At year-end, the bond proceeds investment accounts had the following investments and maturities (dollars in thousands):

Investment Type	Carrying Amount	Weighted Average Maturity (Days)
U.S. Agencies	\$ 277,338	11
Commercial paper	29,600	91
Repurchase agreements	215,474	7
Total investments	<u>\$ 522,412</u>	

Interest Rate Risk and Credit Risk. As established in the contract with the private investment company, all bond proceeds are managed in compliance with General Statute 147-69.1, which limits credit risk as described above, and can only be invested in short-term maturities with the average maturity ranging between overnight to six months based on the liquidity needs of the investment accounts. As of June 30, 2006, Standard and Poor's rated investments in commercial paper and U.S. agencies as A-1 and AAA, respectively.

Custodial Credit Risk. Investments purchased with bond proceeds were exposed to custodial credit risk since the securities were held by the counterparty and were not registered in the name of the State Treasurer.

University of North Carolina (UNC) Hospitals Investment Account

The State Treasurer has contracted with an external party (Trustee) to create the University of North Carolina Hospitals at Chapel Hill Trust (Trust). The UNC Hospitals are the only depositor in the Trust. However, the Trust is a participant of a commingled equity investment fund. The Trustee manages the assets, primarily in equity and equity-based securities in accordance with the General Statutes. The Trustee maintains custody of the underlying securities in the name of the Trust, services the securities, and maintains all related accounting records. The investments are valued at fair market value.

At year-end, the UNC Hospitals investment account maintained by the State Treasurer had the following investments (settled transactions) (dollars in thousands):

Investment Type	Carrying Amount
Other securities:	
Equity based trust - domestic	\$ 104,825
Equity based trust - international	45,552
Total investment securities	<u>\$ 150,377</u>

Foreign Currency Risk. At year-end, the UNC Hospitals investment account's exposure to foreign currency was as follows (dollars in thousands):

Currency	Carrying Value by Investment Type Equity Based Trust- International
Euro	\$ 14,529
Japanese Yen	10,357
Pound Sterling	9,829
Canadian Dollar	3,446
Swiss Franc	2,783
Australian Dollar	2,236
Hong Kong Dollar	1,744
South Korean Won	1,326
Swedish Krona	994
Other Currencies	4,402
Total	<u>\$ 51,646</u>

Note: The totals in this table do not agree to the totals disclosed in the investment table above because this foreign currency table includes equities based on trade date while the investment table is reported on settle date.

Escheat Investment Account

Pursuant to General Statute 147-69.2(b)(12), the State Treasurer has established a separate investment account on behalf of the Escheat Fund. A real estate investment trust under contract with the State Treasurer manages the account.

At year-end, the Escheat Fund invested in a Real Estate account, which held \$20 million in cash. These funds were on deposit at a private investment bank in a short-term investment fund pending transfer into the investment fund on July 3, 2006.

Custodial Credit Risk. For deposits, custodial credit risk is the risk that in the event of a bank failure, the State's deposit may not be recovered. At year-end, the deposit held at the private investment bank was exposed to custodial credit risk because it was uninsured and not fully collateralized.

B. Deposits Outside the State Treasurer

In addition to the pooled deposits maintained by the State Treasurer, other deposits are maintained outside the State Treasurer by the primary government and certain component units. As a general rule, these deposits are not covered by the rules in Chapter 20 NCAC 7 requiring collateralization of uninsured deposits.

NOTES TO THE FINANCIAL STATEMENTS**Primary Government**

The majority of deposits held outside the State Treasurer were maintained by the Employment Security Commission and the various clerks of superior court. General Statute 96-6 requires that Employment Security Commission funds be deposited with the United States Treasury to the credit of North Carolina. The clerks of superior court do not have a deposit policy for custodial credit risk. At year-end, the bank balances maintained outside the State Treasurer by the primary government were exposed to custodial credit risk as follows (dollars in thousands):

Uninsured and uncollateralized	\$	33,640
Uninsured and collateral held by pledging bank		13
Uninsured and collateral held by pledging bank's trust department but not in State's name		233
Total	\$	<u>33,886</u>

Component Units**(University of North Carolina System and State Education Assistance Authority)**

The University of North Carolina (UNC) System does not have a deposit policy for custodial credit risk. At year-end, the bank balances maintained outside the State Treasurer by the UNC System were exposed to custodial credit risk as follows (dollars in thousands):

Uninsured and uncollateralized	\$	177,369
Uninsured and collateral held by pledging bank		286
Uninsured and collateral held by pledging bank's trust department or agent but not in State's name		11
Total	\$	<u>177,666</u>

The State Education Assistance Authority does not have a deposit policy for custodial credit risk. At year-end, the bank balances maintained outside the State Treasurer by the State

Education Assistance Authority were exposed to custodial credit risk as follows (dollars in thousands):

Uninsured and collateral held by pledging bank	\$	23,275
Uninsured and collateral held by pledging bank's trust department or agent but not in State's name		6,973
Total	\$	<u>30,248</u>

C. Investments Outside the State Treasurer

Investments in participating investment contracts, external investment pools, open-end mutual funds, debt securities, equity securities, and all investments of the Deferred Compensation Plan are reported at fair value. Investments in certificates of deposit, investment agreements, bank investment contracts, real estate, real estate investment trusts, and limited partnerships are reported at cost. Detailed disclosures about investments held outside the State Treasurer are presented below.

Primary Government

At year-end, 77% of investments held outside the State Treasurer were maintained by the Supplemental Retirement Income Plan of North Carolina.

Supplemental Retirement Income Plan of North Carolina

The General Statutes place no specific investment restrictions on the Supplemental Retirement Income Plan of North Carolina (the Plan). However, in the absence of specific legislation, the form of governance over the investments would be the prudent-person or prudent-expert rule. These rules are broad statements of intent, generally requiring investment selection and management to be made with prudent, discreet, and intelligent judgment and care. The Plan does not have formal investment policies that address interest rate risk, credit risk, custodial credit risk, concentration of credit risk, or foreign currency risk.

NOTES TO THE FINANCIAL STATEMENTS

At December 31, 2005, the Supplemental Retirement Income Plan of North Carolina had the following investments and maturities that were maintained outside the State Treasurer (dollars in thousands):

Investment Type	Carrying Amount	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More Than 10
Debt securities:					
Fidelity Intermediate Bond Fund	\$ 209,248	\$ —	\$ 209,248	\$ —	\$ —
Prudential Stable Value Fund:					
U.S. Treasuries	228,378	25,429	117,001	31,613	54,335
U.S. agencies	96,190	—	79,891	9,507	6,792
Collateralized mortgage obligations	297,945	42,580	1,731	858	252,776
State and local government	2,888	—	—	—	2,888
Asset-backed securities	37,225	—	—	5,951	31,274
Money market mutual funds	5,119	5,119	—	—	—
Domestic corporate bonds	167,623	3,433	80,160	51,810	32,220
Foreign corporate bonds	26,612	—	18,290	3,958	4,364
Foreign government bonds	8,343	—	3,089	2,412	2,842
	1,079,571	\$ 76,561	\$ 509,410	\$ 106,109	\$ 387,491
Other securities:					
International mutual funds	123,429				
Other mutual funds	2,106,586				
Prudential Stable Value Fund:					
Amount guaranteed by insurance company	17,387				
Total investment securities	\$ 3,326,973				

The Prudential Stable Value Fund is a trust product and is comprised of a group annuity contract issued by The Prudential Insurance Company of America and a portfolio of assets owned by the Plan. Principal and accrued interest is guaranteed by The Prudential Insurance Company of America.

Interest Rate Risk and Credit Risk. The Fidelity Intermediate Bond Fund, which is unrated, had a weighted average maturity of 4.5 years as of April 30, 2006. In the above table, it is disclosed as an investment with a maturity of one to five years. Of the underlying securities in the Prudential Stable Value Fund with credit risk exposure, \$230.74 million were rated BBB or above by Standard & Poor's and \$633.79 million were unrated.

Custodial Credit Risk. The Prudential Stable Value Fund had a custodial credit risk exposure of \$865.2 million because the underlying securities were uninsured, unregistered, and held by the counterparty.

Concentration of Credit Risk. More than 5% of the Plan's investment is in collateralized mortgage obligations issued by the Federal National Mortgage Association. These investments were 5.3% of the Plan's total investments.

Foreign Currency Risk. The Plan owns two international mutual funds, the American Europacific Growth Fund and the T. Rowe Price International Stock Fund. These funds had a carrying value of \$122.84 million and \$588.56 thousand, respectively, at December 31, 2005.

Other Primary Government Investments

The other primary government investments held outside the State Treasurer consisted almost entirely of balances maintained by the North Carolina Public Employee Deferred Compensation Plan (the Plan) and separate investment accounts held by trustees for special obligation debt issues to comply with IRS regulations on bond arbitrage.

General Statute 143B-426.24(j) allows the Deferred Compensation Plan Board to acquire investment vehicles from any company authorized to conduct such business in this State or may establish, alter, amend and modify, to the extent it deems necessary or desirable, a trust for the purpose of facilitating the administration, investment and maintenance of assets acquired by the investment of deferred funds. All assets of the Plan, including all deferred amounts, property and rights purchased with deferred amounts, and all income attributed thereto shall be held in trust for the exclusive benefit of the Plan participants and their beneficiaries.

NOTES TO THE FINANCIAL STATEMENTS

At year-end, the other primary government investments maintained outside the State Treasurer had the following investments and maturities (dollars in thousands):

Investment Type	Carrying Amount	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More Than 10
Debt securities:					
U.S. Treasuries	\$ 696	\$ 104	\$ 406	\$ 163	\$ 23
U.S. Treasury STRIPS	873	185	688	—	—
U.S. agencies	2,409	158	395	1,849	7
Mortgage pass throughs	154	—	24	2	128
Collateralized mortgage obligations	58	2	50	6	—
State and local government	108	—	99	8	1
Asset-backed securities	26	—	—	9	17
Repurchase agreements	164,775	153,151	11,624	—	—
Commercial paper	586	586	—	—	—
Annuity contracts	36,157	—	36,157	—	—
Money market mutual funds	5,094	5,094	—	—	—
Mutual bond funds	11,219	—	—	11,217	2
Domestic corporate bonds	62	—	27	25	10
	222,217	\$ 159,280	\$ 49,470	\$ 13,279	\$ 188
Other securities:					
Other mutual funds	610,781				
Real estate investment trusts	20,000				
Domestic stocks	58,952				
Other	557				
Total investment securities	\$ 912,507				

Interest Rate Risk and Credit Risk. The special obligation debt proceeds are generally invested in repurchase agreements. As established in the debt covenants, repurchase agreements with respect to government obligations can only be entered into with 1) a dealer recognized as a primary dealer by a Federal Reserve Bank with a short-term rating not less than P-1 from Moody's Investors Service (Moody's) and not less than A-1 from Standard & Poor's (S&P) and Fitch Ratings (Fitch); or 2) any commercial bank, trust company, or national banking association rated A or better by Moody's, S&P and Fitch, the deposits of which are insured by the Federal Deposit Insurance Corporation. There are no formally adopted investment policies or debt covenants for special obligation debt proceeds that address interest rate risk.

At year-end, the other primary government investments maintained outside the State Treasurer had the following credit quality distribution for securities with credit exposure (dollars in thousands):

Investment Type	Carrying Amount by Credit Rating - Moody's/S&P/Fitch					
	Aaa/AAA	Aa/AA	A	Baa/BBB	Ba/BB and Below	Unrated
U.S. agencies	\$ 2,409	\$ —	\$ —	\$ —	\$ —	\$ —
Mortgage pass throughs	128	—	—	—	—	19
Collateralized mortgage obligations	28	9	12	3	—	4
State and local government	107	1	—	—	—	—
Asset-backed securities	26	—	—	—	—	—
Repurchase agreements	11,623	—	—	—	—	—
Commercial paper	—	—	586	—	—	—
Annuity contracts	—	—	—	—	36,157	—
Money market mutual funds	4,917	—	—	—	—	177
Mutual bond funds	9,737	447	447	336	224	28
Domestic corporate bonds	4	11	23	23	1	—
Total	<u>\$ 28,979</u>	<u>\$ 468</u>	<u>\$ 1,068</u>	<u>\$ 362</u>	<u>\$ 36,382</u>	<u>\$ 228</u>

NOTES TO THE FINANCIAL STATEMENTS

Component Units

(University of North Carolina System and State Education Assistance Authority)

University of North Carolina System

The General Statutes place no specific investment restrictions on the University of North Carolina System (the UNC System). However, in the absence of specific legislation, the form of governance over these investments would be the prudent-person or prudent-expert rule. These rules are broad statements of intent, generally requiring investment selection and management to be made with prudent, discreet, and intelligent judgment and care. The University of North Carolina at Chapel Hill (the University) operates an Investment Fund, which is a governmental external investment pool. The University operates the Investment Fund for charitable, nonprofit foundations, associations, trusts, endowments and funds that are organized and operated primarily to support the University. Separate financial statements for the Investment Fund may be obtained from the University.

At year-end, the UNC System had the following investments and maturities that were maintained outside the State Treasurer (dollars in thousands):

Investment Type	Carrying Amount	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More Than 10
Debt securities:					
U.S. Treasuries	\$ 43,386	\$ 5,533	\$ 16,297	\$ 445	\$ 21,111
U.S. Treasury STRIPS	2,337	—	2,337	—	—
U.S. agencies	38,033	13,325	18,135	2,600	3,973
Mortgage pass throughs	68,032	1,292	6,035	13,617	47,088
Collateralized mortgage obligations	142,218	—	2,088	6,026	134,104
State and local government	2,508	60	2,216	83	149
Asset-backed securities	1,991	—	—	1,428	563
Repurchase agreements	672	—	672	—	—
Money market mutual funds	220,849	220,849	—	—	—
Mutual bond funds	175,759	21,661	37,498	108,313	8,287
Domestic corporate bonds	36,476	2,057	18,522	1,501	14,396
Foreign corporate bonds	9,456	15	5,066	4,361	14
	<u>741,717</u>	<u>\$ 264,792</u>	<u>\$ 108,866</u>	<u>\$ 138,374</u>	<u>\$ 229,685</u>
Other securities:					
International mutual funds	79,820				
Other mutual funds	425,466				
Investments in real estate	56,164				
Real estate investment trusts	14,708				
Limited partnerships	857,899				
Pooled investments	359				
Domestic stocks	266,709				
Foreign stocks	37,875				
Other	610,444				
Total investment securities	<u>\$ 3,091,161</u>				

Limited Partnerships – The limited partnership positions are primarily held by the University of North Carolina at Chapel Hill. The University uses various external money managers to identify specific investment funds and limited partnerships that meet asset allocation and investment management objectives. The University invests in these funds and partnerships to increase the yield and return on its investment portfolio given the available alternative investment opportunities and to diversify its asset holdings. These investments generally include equity and bond funds. Certain investment funds expose the University to significant amounts of market risk by trading or holding derivative securities and by leveraging the securities in the fund. The University limits the amount of funds managed by any single asset manager and also limits the amount of funds to be invested in particular security classes.

Interest Rate Risk and Credit Risk. The constituent institutions of the UNC System generally do not have formal investment policies that address interest rate risk or credit risk. At year-end, the UNC System's investments maintained outside the State Treasurer had the following credit quality distribution for securities with credit exposure (dollars in thousands):

NOTES TO THE FINANCIAL STATEMENTS

Investment Type	Carrying Amount by Credit Rating - Moody's/S&P/Fitch					
	Aaa/AAA	Aa/AA	A	Baa/BBB	Ba/BB and Below	Unrated
U.S. agencies	\$ 13,380	\$ 3,139	\$ —	\$ —	\$ —	\$ 18,576
Mortgage pass throughs	4,739	—	—	—	—	62,907
Collateralized mortgage obligations	72,433	8,407	38,573	1,275	—	21,482
State and local government	2,306	107	—	35	—	60
Asset-backed securities	1,457	—	35	499	—	—
Money market mutual funds	45,658	—	169,138	—	—	6,053
Mutual bond funds	71,971	60,351	17,013	5,790	14,629	6,005
Domestic corporate bonds	6,362	1,028	18,140	10,654	292	—
Foreign corporate bonds	—	5,026	37	47	4,346	—
Total	\$ 218,306	\$ 78,058	\$ 242,936	\$ 18,300	\$ 19,267	\$ 115,083

Custodial Credit Risk. The constituent institutions of the UNC System generally do not have formal investment policies that address custodial credit risk. At year-end, the UNC System's investments maintained outside the State Treasurer were exposed to custodial credit risk as follows (dollars in thousands):

Investment Type	Carrying Amount	
	Held by Counterparty	Held by Counterparty's Trust Dept. or Agent but not in State's Name
U.S. Treasuries	\$ 12,620	\$ 640
U.S. agencies	13,895	—
Mortgage pass throughs	15,801	—
Collateralized mortgage obligations	9,094	—
Repurchase agreements	672	—
Domestic corporate bonds	14,245	—
Domestic stocks	53,291	—
Foreign stocks	281	—
Total	\$ 119,899	\$ 640

Foreign Currency Risk. The constituent institutions of the UNC System do not have formal investment policies that address foreign currency risk. At year-end, the UNC System's investments maintained outside the State Treasurer were exposed to foreign currency risk as follows (dollars in thousands):

Currency	Carrying Amount	
	Foreign Stocks	Limited Partnerships
Euro	\$ 1,607	\$ 21,395
Japanese Yen	16,060	667
Pound Sterling	—	4,462
Canadian Dollar	3,798	—
Singapore Dollar	1,624	—
Other Currencies	1,569	89
Total	\$ 24,658	\$ 26,613

NOTES TO THE FINANCIAL STATEMENTS

The State Education Assistance Authority

The State Education Assistance Authority (the Authority) is authorized by the University of North Carolina Board of Governors pursuant to General Statute 116-36.2 to invest its special funds in the same manner as the State Treasurer is required to invest, as discussed in Section A of this note.

Investments. In accordance with bond resolutions, bond proceeds and debt service funds are invested in obligations that will by their terms mature on or before the date funds are expected to be required for expenditure or withdrawal.

The Authority does not have a formal investment policy that addresses interest rate risk. The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2006, for the Authority's investments (dollars in thousands):

Investment Type	Carrying Amount	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More Than 10
Debt securities:					
U.S. Treasuries	\$ 12,220	\$ —	\$ 386	\$ 7,092	\$ 4,742
Repurchase agreements	8,869	—	—	3,657	5,212
Mutual bond funds	29,646	—	—	29,646	—
Money market mutual funds	489	489	—	—	—
	51,224	\$ 489	\$ 386	\$ 40,395	\$ 9,954
Other securities:					
International mutual funds	18,759				
Other mutual funds	101,897				
Domestic stocks	19,822				
Investment contracts	326,611				
Other	15,402				
Total investment securities	\$ 533,715				

Credit Risk. The Authority has formally adopted investment policies for credit risk stating that certain investment obligations shall bear one of the two highest ratings by nationally recognized rating services. As of June 30, 2006, the Authority's investments were rated as follows (dollars in thousands):

Investment Type	Carrying Amount by Credit Rating - S&P	
	Aaa/AAA	Unrated
Repurchase agreements	\$ —	\$ 8,869
Money market mutual funds	—	489
Mutual bond funds	12,431	17,215
Total	\$ 12,431	\$ 26,573

Custodial Credit Risk. The Authority does not have a formal policy that addresses custodial credit risk. The Authority's investments were exposed to custodial credit risk as follows (dollars in thousands):

Investment Type	Carrying Amount Held by Counterparty's Trust Dept. or Agent but not in State's Name
Repurchase agreements	\$ 8,869
Domestic Stocks	19,822
Total	\$ 28,691

Concentration of Credit Risk. The Authority places no limit on the amount that may be invested in any one issuer. More than 5% of the Authority's investments are in Trinity Funding, FSA Capital Management, and IXIS Funding. These investments are 33.05%, 10.7%, and 17.45%, respectively, of the Authority's investments.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 4: RECEIVABLES

Receivables at year-end are reported net of allowances for doubtful accounts as follows (dollars in thousands):

Governmental Activities:

	General Fund	Highway Fund	Highway Trust Fund	Other Governmental Funds	Internal Service Funds ⁽¹⁾	Total
Receivables, gross (excluding notes).....	\$ 3,568,231	\$ 184,010	\$ 41,294	\$ 41,473	\$ 10,160	\$ 3,845,168
Allowance for doubtful accounts.....	(443,626)	(6,834)	—	(61)	—	(450,521)
Receivables, net.....	<u>\$ 3,124,605</u>	<u>\$ 177,176</u>	<u>\$ 41,294</u>	<u>\$ 41,412</u>	<u>\$ 10,160</u>	<u>\$ 3,394,647</u>
Notes receivable, gross.....	\$ 6,578	\$ 1,102	\$ 107	\$ 375,652	\$ —	\$ 383,439
Allowance for doubtful accounts.....	—	—	—	(41,290)	—	(41,290)
Notes receivable, net.....	<u>\$ 6,578</u>	<u>\$ 1,102</u>	<u>\$ 107</u>	<u>\$ 334,362</u>	<u>\$ —</u>	<u>\$ 342,149</u>

(1) Includes balances due from fiduciary funds.

Within governmental activities, the only significant receivables not expected to be collected within one year are \$217.39 million of notes receivable in other governmental funds, \$6.58 million of notes receivable in the General Fund and \$5.84 million in accounts receivable in the General Fund.

Business-Type Activities:

	Unemployment Compensation Fund	EPA Revolving Loan Fund	N.C. State Lottery Fund	Other Enterprise Funds	Total
Receivables, gross (excluding notes).....	\$ 432,699	\$ 4,013	\$ 10,231	\$ 8,444	\$ 455,387
Allowance for doubtful accounts.....	(48,446)	—	—	(20)	(48,466)
Receivables, net.....	<u>\$ 384,253</u>	<u>\$ 4,013</u>	<u>\$ 10,231</u>	<u>\$ 8,424</u>	<u>\$ 406,921</u>
Notes receivable, gross.....	\$ —	\$ 545,570	\$ —	\$ —	\$ 545,570
Allowance for doubtful accounts.....	—	—	—	—	—
Notes receivable, net.....	<u>\$ —</u>	<u>\$ 545,570</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 545,570</u>

Within business-type activities, the only significant receivables not expected to be collected within one year are \$513.14 million of notes receivable in the EPA Revolving Loan Fund. Revenues of other enterprise funds are net of uncollectible amounts. The total amounts related to revenues of the current period are \$24 thousand related to sales and services used as security for bonds.

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NOTES TO THE FINANCIAL STATEMENTS

NOTE 5: CAPITAL ASSETS

Primary Government. A summary of changes in capital assets for the year ended June 30, 2006 is presented below (dollars in thousands).

Governmental Activities:

	Balance July 1, 2005 (as restated)	Additions	Deductions	Balance June 30, 2006
Capital Assets, nondepreciable:				
Land	\$ 8,913,829	\$ 530,808	\$ (5,021)	\$ 9,439,616
Art, literature, and other artifacts	48,975	11,510	—	60,485
Construction in progress	1,960,204	1,540,342	(1,782,418)	1,718,128
Total capital assets-nondepreciable	10,923,008	2,082,660	(1,787,439)	11,218,229
Capital Assets, depreciable:				
Buildings	2,300,307	263,719	(37,043)	2,526,983
Machinery and equipment	1,502,431	134,607	(91,287)	1,545,751
Intangibles	200,146	4,215	(5,366)	198,995
General infrastructure	176,331	5,975	(10,966)	171,340
State highway system	19,419,720	1,540,182	(41,439)	20,918,463
Total capital assets-depreciable	23,598,935	1,948,698	(186,101)	25,361,532
Less accumulated depreciation for:				
Buildings	(667,366)	(52,863)	17,436	(702,793)
Machinery and equipment	(947,947)	(109,104)	77,318	(979,733)
Intangibles	(94,101)	(4,870)	5,232	(93,739)
General infrastructure	(97,273)	(5,889)	9,062	(94,100)
State highway system	(5,172,498)	(418,274)	40,611	(5,550,161)
Total accumulated depreciation	(6,979,185)	(591,000)	149,659	(7,420,526)
Total capital assets-depreciable, net	16,619,750	1,357,698	(36,442)	17,941,006
Governmental activities capital assets, net	\$ 27,542,758	\$ 3,440,358	\$ (1,823,881)	\$ 29,159,235

NOTES TO THE FINANCIAL STATEMENTS

Business-type Activities:

	Balance July 1, 2005 (as restated)	Additions	Deductions	Balance June 30, 2006
Capital Assets, nondepreciable:				
Land	\$ 3,147	\$ —	\$ —	\$ 3,147
Construction in progress	1,811	482	—	2,293
Total capital assets-nondepreciable	4,958	482	—	5,440
Capital Assets, depreciable:				
Buildings	33,982	—	—	33,982
Machinery and equipment	5,661	1,043	(1,505)	5,199
General infrastructure	47,304	218	—	47,522
Intangible Assets	1,569	—	(112)	1,457
Total capital assets-depreciable	88,516	1,261	(1,617)	88,160
Less accumulated depreciation for:				
Buildings	(18,472)	(812)	—	(19,284)
Machinery and equipment	(3,822)	(253)	1,338	(2,737)
General infrastructure	(16,535)	(2,015)	—	(18,550)
Total accumulated depreciation	(38,829)	(3,080)	1,338	(40,571)
Total capital assets-depreciable, net	49,687	(1,819)	(279)	47,589
Business-type activities capital assets, net	\$ 54,645	\$ (1,337)	\$ (279)	\$ 53,029

Depreciation expense was charged to functions/programs of the primary government as follows (dollars in thousands):

Governmental activities:

General government	\$ 36,206
Primary and secondary education	1,977
Higher Education	60
Health and human services	12,640
Economic development	1,205
Environment and natural resources	12,881
Public safety, correction, and regulation	49,059
Transportation	473,093
Agriculture	3,880
Total depreciation expense	\$ 591,001

Business-type activities:

Town of Butner Water and Sewer	\$ 1,662
N.C. State Fair	618
USS North Carolina Battleship Commission	128
Agricultural Farmers Market	292
EPA Revolving Loan Fund	21
State Banking Commission	8
ABC Commission	117
Utilities Commission	67
N.C. State Lottery	76
Other business-type activities	91
Total depreciation expense	\$ 3,080

NOTES TO THE FINANCIAL STATEMENTS

Component Units (University of North Carolina System and Community Colleges). Capital asset activity for the University of North Carolina System and Community Colleges for the fiscal year ended June 30, 2006, was as follows (dollars in thousands):

University of North Carolina System:

	Balance July 1, 2005 (as restated)	Additions	Deductions	Balance June 30, 2006
Capital Assets, nondepreciable:				
Land	\$ 195,536	\$ 6,303	\$ (262)	\$ 201,577
Art, literature, and other artifacts	99,433	8,824	(380)	107,877
Construction in progress	1,032,320	720,760	(653,182)	1,099,898
Total capital assets-nondepreciable	1,327,289	735,887	(653,824)	1,409,352
Capital Assets, depreciable:				
Buildings	5,208,707	848,363	(5,906)	6,051,164
Machinery and equipment	1,288,032	124,414	(66,489)	1,345,957
Intangibles	1,000	—	—	1,000
Art, literature, and other artifacts	1,907	59	—	1,966
General infrastructure	803,270	38,308	(136)	841,442
Total capital assets-depreciable	7,302,916	1,011,144	(72,531)	8,241,529
Less accumulated depreciation for:				
Buildings	(1,585,088)	(151,747)	5,451	(1,731,384)
Machinery and equipment	(833,777)	(101,556)	55,337	(879,996)
Art, literature, and other artifacts	(800)	(149)	—	(949)
General infrastructure	(270,986)	(28,160)	149	(298,997)
Total accumulated depreciation	(2,690,651)	(281,612)	60,937	(2,911,326)
Total capital assets-depreciable, net	4,612,265	729,532	(11,594)	5,330,203
University of North Carolina System capital assets, net	\$ 5,939,554	\$ 1,465,419	\$ (665,418)	\$ 6,739,555

Capital assets of nongovernmental component units of the University of North Carolina System are excluded from the above amounts. At June 30, 2006, nongovernmental component unit foundations and similarly affiliated organizations of the University of North Carolina System had nondepreciable capital assets of \$29.961 million and net depreciable capital assets of \$149.873 million.

NOTES TO THE FINANCIAL STATEMENTS

Community Colleges:

	Balance July 1, 2005 (as restated)	Additions	Deductions	Balance June 30, 2006
Capital Assets, nondepreciable:				
Land	\$ 97,412	\$ 4,692	\$ —	\$ 102,104
Art, literature, and other artifacts	355	—	—	355
Construction in progress	232,469	129,651	(159,657)	202,463
Total capital assets-nondepreciable	<u>330,236</u>	<u>134,343</u>	<u>(159,657)</u>	<u>304,922</u>
Capital Assets, depreciable:				
Buildings	1,341,716	176,572	(938)	1,517,350
Machinery and equipment	183,689	22,969	(7,577)	199,081
Art, literature, and other artifacts	46	—	—	46
General infrastructure	68,333	9,964	(62)	78,235
Total capital assets-depreciable	<u>1,593,784</u>	<u>209,505</u>	<u>(8,577)</u>	<u>1,794,712</u>
Less accumulated depreciation for:				
Buildings	(409,724)	(35,667)	539	(444,852)
Machinery and equipment	(111,451)	(13,600)	6,522	(118,529)
Art, literature, and other artifacts	(18)	(3)	—	(21)
General infrastructure	(33,427)	(3,319)	64	(36,682)
Total accumulated depreciation	<u>(554,620)</u>	<u>(52,589)</u>	<u>7,125</u>	<u>(600,084)</u>
Total capital assets-depreciable, net	<u>1,039,164</u>	<u>156,916</u>	<u>(1,452)</u>	<u>1,194,628</u>
Community Colleges capital assets, net	<u>\$ 1,369,400</u>	<u>\$ 291,259</u>	<u>\$ (161,109)</u>	<u>\$ 1,499,550</u>

Capital assets of nongovernmental component units of community colleges are excluded from the above amounts. At June 30, 2006, nongovernmental component unit foundations and similarly affiliated organizations of community colleges had nondepreciable capital assets of \$1.194 million and net depreciable capital assets of \$1.780 million.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 6: SHORT-TERM DEBT

Primary Government

Beginning January 1, 2006, the State received repayable advances from the Federal Unemployment Account (FUA) to finance an operating deficit in the State's unemployment compensation fund. The tax anticipation notes issued for the period September 30, 2005 through December 31, 2005 were repaid as employer contributions became available beginning January 1, 2006. Once the tax anticipation notes were repaid in total, the State used the employer contributions to pay back the FUA borrowing as of May 31, 2006. Advances taken from January 1, 2006 through September 30, 2006, which are repaid in full on or before September 30, 2006 are considered cash flow advances and do not accrue interest provided that the State does not take additional advances from October 1, 2006 through December 31, 2006. The State does not plan to take additional FUA advances or issue tax anticipation notes through December 31, 2006.

Short-term debt activity for the fiscal year ended June 30, 2006, was as follows (dollars in thousands):

	<u>Balance</u> <u>July 1, 2005</u>	<u>Draws</u>	<u>Repayments</u>	<u>Balance</u> <u>June 30, 2006</u>
FUA Advance.....	\$ 113,690	\$ 256,185	\$ (369,875)	\$ —
Anticipation Notes.....	—	77,133	(77,133)	—

Component Units**University of North Carolina System**

North Carolina State University has available commercial paper program financing for short-term credit up to \$100 million to finance capital construction projects. The University's available funds are pledged to the commercial paper program financing with the anticipation of converting to general revenue bond financing in the future. As of June 30, 2006, \$16 million in tax-exempt commercial paper was outstanding.

Commercial paper was issued from the University of North Carolina General Revenue Bonds, Series 2002A, to provide interim financing for the construction of capital projects. Commercial paper was redeemed with proceeds from the University of North Carolina General Revenue Refunding Bonds, Series 2005.

North Carolina A&T University borrowed \$6.168 million June 1, 2006. Proceeds from the note are being used for capital construction projects. The note will be repaid from bond proceeds when the University issues bonds in the fall of 2006.

Short-term debt activity for the University of North Carolina System for the fiscal year ended June 30, 2006, was as follows (dollars in thousands):

	<u>Balance</u> <u>July 1, 2005</u>	<u>Draws</u>	<u>Repayments</u>	<u>Balance</u> <u>June 30, 2006</u>
Commercial Paper Program.....	\$ 143,141	\$ 113,000	\$ (122,727)	\$ 133,414
Anticipation Notes.....	—	6,168	—	6,168

NOTES TO THE FINANCIAL STATEMENTS

NOTE 7: LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities

Primary Government. Long-term liability activity for the year ended June 30, 2006, was as follows (dollars in thousands):

	Balance July 1, 2005 (as restated)	Increases	Decreases	Balance June 30, 2006	Amounts Due Within One Year
Governmental activities:					
Bonds and similar debt payable:					
General obligation bonds	\$5,698,535	\$ 370,000	\$ (329,720)	\$ 5,738,815	\$ 343,615
Lease-purchase revenue bonds	265,045	—	(10,000)	255,045	10,000
Certificates of participation	475,170	—	(21,110)	454,060	21,420
Less deferred amounts:					
For issuance discounts	(1,175)	—	454	(721)	—
On refunding	(119,653)	—	16,594	(103,059)	—
Add issuance premium	339,004	15,700	(41,451)	313,253	—
Total bonds and similar debt payable	6,656,926	385,700	(385,233)	6,657,393	375,035
Notes payable	37,107	30,688	(6,954)	60,841	26,334
Capital leases payable	297	26,745	(163)	26,879	982
Arbitrage rebate payable	—	508	—	508	—
Compensated absences	320,595	270,792	(216,592)	374,795	36,679
Net pension obligation	2,044	14,544	(14,961)	1,627	—
Workers' compensation	5,500	583	(817)	5,266	1,122
Deferred death benefit payable	400	—	(60)	340	210
Cost settlement payable	5,000	151,500	(2,500)	154,000	109,000
Governmental activity long-term liabilities	<u>\$7,027,869</u>	<u>\$ 881,060</u>	<u>\$ (627,280)</u>	<u>\$ 7,281,649</u>	<u>\$ 549,362</u>
Business-type activities:					
Bonds payable:					
Revenue bonds	\$ 9,070	\$ —	\$ (270)	\$ 8,800	\$ 280
Total bonds payable	9,070	—	(270)	8,800	280
Notes payable	1,569	—	(112)	1,457	112
Compensated absences	2,379	2,650	(1,222)	3,807	195
Business-type activity long-term liabilities	<u>\$ 13,018</u>	<u>\$ 2,650</u>	<u>\$ (1,604)</u>	<u>\$ 14,064</u>	<u>\$ 587</u>

For governmental activities, the compensated absences, net pension obligation, workers' compensation, and cost settlement liabilities are generally liquidated by the General Fund. Arbitrage rebate payable is generally liquidated by other governmental funds. A portion of compensated absences is also liquidated by the Highway Fund. Internal service funds predominantly serve the governmental funds. Accordingly, long-term liabilities for them are included as part of the above totals for governmental activities. At year-end, \$3.861 million of internal service funds compensated absences are included in the above amounts.

NOTES TO THE FINANCIAL STATEMENTS

Component Units (University of North Carolina System, North Carolina Housing Finance Agency, and the State Education Assistance Authority). Long-term liability activity for the year ended June 30, 2006, was as follows (dollars in thousands):

	Balance July 1, 2005	Increases	Decreases	Balance June 30, 2006	Amounts Due Within One Year
University of North Carolina System:					
Bonds payable:					
Revenue bonds	\$1,737,063	\$ 412,160	\$ (129,840)	\$ 2,019,383	\$ 180,876
Certificates of participation	31,185	—	(1,395)	29,790	1,755
Less deferred amounts:					
For issuance discounts	(52,499)	—	3,928	(48,571)	—
On refunding	(27,064)	(2,286)	2,070	(27,280)	—
Add issuance premium	25,043	21,263	(2,360)	43,946	—
Total bonds payable	1,713,728	431,137	(127,597)	2,017,268	182,631
Notes payable	69,780	98,787	(39,917)	128,650	38,344
Capital leases payable	43,649	63,155	(3,379)	103,425	9,042
Arbitrage rebate payable	3,795	116	(3,622)	289	20
Annuity and life income payable	10,688	1,342	(1,051)	10,979	973
Compensated absences	233,424	206,350	(171,384)	268,390	27,534
Total long-term liabilities	<u>\$2,075,064</u>	<u>\$ 800,887</u>	<u>\$ (346,950)</u>	<u>\$ 2,529,001</u>	<u>\$ 258,544</u>

Long-term liabilities of nongovernmental component units of the University of North Carolina System are excluded from the above amounts. At June 30, 2006, nongovernmental component unit foundations and similarly affiliated organizations of the University of North Carolina System had total long-term liabilities of \$336.963 million, of which \$17.178 million was due within one year and \$319.785 million was due in more than one year.

	Balance July 1, 2005	Increases	Decreases	Balance June 30, 2006	Amounts Due Within One Year
North Carolina Housing Finance Agency:					
Bonds payable:					
Revenue bonds	\$1,311,865	\$ 400,000	\$ (146,985)	\$ 1,564,880	\$ 178,050
Less deferred amounts:					
For issuance discounts	(19,569)	(2,780)	3,306	(19,043)	—
On refunding	(145)	—	40	(105)	—
Total bonds payable	1,292,151	397,220	(143,639)	1,545,732	178,050
Arbitrage rebate payable	297	308	(257)	348	144
Compensated absences	583	347	(272)	658	30
Total long-term liabilities	<u>\$1,293,031</u>	<u>\$ 397,875</u>	<u>\$ (144,168)</u>	<u>\$ 1,546,738</u>	<u>\$ 178,224</u>

	Balance July 1, 2005	Increases	Decreases	Balance June 30, 2006	Amounts Due Within One Year
State Education Assistance Authority:					
Bonds payable:					
Revenue bonds	\$1,921,562	\$ 806,300	\$ (169,208)	\$ 2,558,654	\$ 506,300
Total bonds payable	1,921,562	806,300	(169,208)	2,558,654	506,300
Arbitrage rebate payable	2,801	1,352	—	4,153	74
Compensated absences	190	75	(9)	256	9
Total long-term liabilities	<u>\$1,924,553</u>	<u>\$ 807,727</u>	<u>\$ (169,217)</u>	<u>\$ 2,563,063</u>	<u>\$ 506,383</u>

NOTES TO THE FINANCIAL STATEMENTS**B. Bonds, Certificates of Participation, and Notes Payable**

Bonds, certificates of participation, and notes payable at June 30, 2006 were as follows (dollars in thousands):

	<u>Interest Rates</u>	<u>Maturing Through Year</u>	<u>Original Issue Amount</u>	<u>Outstanding Balance</u>
Primary Government:				
<u>Governmental activities</u>				
General obligation bonds.....	2.13% - 6.90%*	2028	\$ 8,201,384	\$ 5,738,815
Lease-purchase revenue bonds.....	2.00% - 5.25%	2024	272,045	255,045
Certificates of participation.....	3.25% - 5.25%	2025	489,840	454,060
Notes payable.....	2.89% - 6.00%	2016	74,416	60,841
<u>Business-type activities</u>				
Revenue bonds.....	3.38% - 4.21%*	2026	\$ 9,905	\$ 8,800
Notes payable.....	0.00%	2019	1,569	1,457
Component Units:				
<u>University of North Carolina System</u>				
Revenue bonds.....	1.63% - 10.00%*	2036	\$ 2,329,204	\$ 2,019,383
Certificates of participation.....	3.00% - 5.00%	2035	31,545	29,790
Notes payable.....	0.91% - 9.45%*	2035	147,563	128,650
<u>North Carolina Housing Finance Agency</u>				
Revenue bonds.....	2.00% - 8.25%*	2043	\$ 3,341,066	\$ 1,564,880
<u>State Education Assistance Authority</u>				
Revenue bonds.....	3.45% - 6.35%*	2035	\$ 2,609,850	\$ 2,558,654

* For variable rate debt, interest rates in effect at June 30, 2006 are included. For variable rate debt with interest rate swaps, the synthetic fixed rates are included.

The full faith, credit, and taxing power of the State are pledged for the payment of principal and interest on general obligation bonds. The certificates of participation (COPs) and lease-purchase revenue bonds issued by the N.C. Infrastructure Finance Corporation, a blended component unit of the State, are secured by lease and installment payments made by the State and in the event of default, by a security interest in the leased facilities pursuant to a leasehold deed of trust (as applicable). The COPs issued for repair and renovation projects are not secured by a lien upon or security interest in the projects or in any other property of the State. All payments of the State for the COPs and lease-purchase revenue bonds are subject to appropriation by the General Assembly. Other long-term debts of the State and its component units are payable solely from certain resources of the funds to which they relate.

C. Bonds Authorized but Unissued

The amount of authorized but unissued general obligation bonds of the primary government at June 30, 2006, totaled \$502.7 million as follows: higher education \$403.5 million and clean water \$99.2 million.

The amount of authorized but unissued debt of the primary government subject to annual appropriation requirements at June 30, 2006 totaled \$682.4 million as follows: repair and renovation \$175 million, universities \$337.1 million, hospital \$49 million, prisons \$52.4 million, youth facilities \$22 million, parks \$20.8 million, and guaranteed energy savings contracts \$26.1 million.

D. Demand Bonds

Included in bonds payable are several variable rate demand bond issues. Demand bonds are securities that contain a "put" feature that allows bondholders to demand payment before the maturity of the debt upon proper notice to the issuer's remarketing or paying agents.

Component Units**University of North Carolina System**

With regards to the following demand bonds, the issuer has not entered into take out agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

The University of North Carolina at Chapel Hill - General Revenue, Series 2001B and 2001C

In 2001 the University issued two series of variable rate demand bonds in the amount of \$54.97 million (2001B) and \$54.97 million (2001C) that each have a final maturity date of December 1, 2025. The bonds are subject to mandatory sinking fund redemption on the interest payment date on or immediately preceding each December throughout the term of the bonds. The proceeds of these issuances were used to provide funds to refund in advance of their maturity the following issues: Ambulatory Care Clinic, Series 1990; Athletic Facilities, Series 1998; Carolina Inn, Series 1994; School of Dentistry, Series 1995; Kenan Stadium, Series 1996; and Parking System, Series

NOTES TO THE FINANCIAL STATEMENTS

1997C. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the University's remarketing agents, Lehman Brothers, Inc (2001B) and UBS Financial Services, Inc. (2001C).

The University renewed its line of credit, in the amount of \$107.46 million, with JP Morgan Chase Bank effective February 1, 2006. Under the line of credit agreement, the University is entitled to draw amounts sufficient to pay the principal and accrued interest on bonds delivered for purchase.

The University is required to pay a quarterly commitment fee for the line of credit of 0.1% per annum based on the unused portion of the line of credit commitment. If the University's credit rating for unsecured debt were to drop below Aa3 (or its equivalent) by Moody's Investors Service (Moody's), AA- (or its equivalent) by Standard & Poor's (S&P), or AA- (or its equivalent) by Fitch Ratings (Fitch), the quarterly commitment fee would increase to 0.15%. If the University's credit rating for unsecured debt were to drop below A3 (or its equivalent) by Moody's, A- (or its equivalent) by S&P, or A- (or its equivalent) by Fitch, the quarterly commitment fee would increase to 0.25%.

Under the line of credit agreement, the University has promised to repay loans that represent purchase drawings in equal semi-annual payments after termination of the line of credit. Interest at the rate of Prime plus 1% (Prime plus 2% after 60 days) is payable quarterly and upon draw repayment. At June 30, 2006, no purchase draws had been made under the line of credit.

The line of credit agreement expires on January 31, 2007. However, between November 3, 2006, and December 3, 2006, the University may request that the Bank extend the expiration date for another year. The Bank shall respond affirmatively or negatively within 30 days after receipt of such request.

North Carolina Central University – Revenue Bonds Series 2003A

In October of 2003, the North Carolina Capital Facilities Finance Agency issued Student Housing Facilities Revenue Demand Bonds (\$21.48 million Variable Rate Revenue Demand Bonds, Series 2003A) that have a maturity date of October 1, 2034. The issuer, the North Carolina Capital Facilities Finance Agency, loaned the proceeds of the Series 2003 Bonds to the NCCU Real Estate Foundation, Inc. (Foundation). The Foundation used the proceeds to finance the costs of building a student housing facility at North Carolina Central University, to fund a debt service reserve fund for the 2003A Bonds, to pay a portion of the interest on the bonds during construction of the project, and to pay certain costs of issuance of the bonds. The 2003A Bonds are subject to mandatory sinking fund redemption at the principal amount on the interest payment dates or immediately preceding October 1, 2006.

The Student Housing Facilities Revenue Demand Bonds (Series 2003) has an Irrevocable Letter of Credit (LOC) for \$21.82 million. The LOC is to secure the payment of the principal and purchase price of interest on the Series 2003 Bonds. The LOC was issued by Wachovia Bank, N.A. and expires on October 15, 2006. The LOC may be extended by request from the Foundation by delivering a notice of extension to the Trustee with a new expiration date. At June 30, 2006, the LOC rate for the bonds was 1.4% and the total amount drawn on it was \$907 thousand.

The Foundation paid Wachovia Bank, N.A. a commitment fee of \$109 thousand for the letter of credit on the date the bonds were issued. Additionally, the Foundation paid credit facility fees in the amount of \$76 thousand during the fiscal year. If the Foundation terminates the letter of credit on or before August 1, 2006, then the Foundation must pay a termination fee of \$25 thousand. The Bonds are not under a take out agreement; however, in the event of termination 100% of the unpaid principal will be due and payable plus any unpaid and accrued interest.

Under the LOC agreement, the proceeds of each drawing under the LOC to pay the portion of the purchase price of Series 2003 bonds allocable to principal will constitute a tender advance and must be reimbursed as provided in the agreement. The Foundation is required to repay each tender advance to Wachovia Bank, N.A. plus an interest rate of Prime plus 1%. The amount of any tender advance made is repaid based on the earliest to occur of the date the credit provider bonds purchased pursuant to such tender advances are remarketed, the close of business on the date that is 180 days after the tender was made, and/or the termination date.

The Student Housing Facilities Revenue Demand Bonds (Series 2003) has remarketing fees. The remarketing fee is an upfront charge to reset the interest rates on a weekly basis. The remarketing agent is Wachovia Bank, N.A. for the Series 2003A Bonds. At June 30, 2006, the remarketing fee rate for the bonds was 0.13%.

State Education Assistance Authority – Guaranteed Student Loan Revenue Bonds, Series 2005A

In October, 2005, the Authority issued Guaranteed Student Loan Revenue Bonds, Series 2005A, in the amount of \$506.3 million consisting of four tranches of tax-exempt bonds totaling \$471.6 million and two tranches of taxable bonds totaling \$34.7 million. This series of bonds matures on September 1, 2035, but \$12.4 million must be retired by mandatory sinking fund redemption on October 1, 2012. The proceeds of this issuance were used to finance student loans, refund the Authority's outstanding Series 1995A bonds, make a deposit to the operating fund, and pay issuance costs. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven day's notice to the tender agent.

Payment of principal and interest on the Series 2005A bonds is insured by a financial guaranty insurance policy by Ambac Assurance Corporation. The Authority has entered into a

NOTES TO THE FINANCIAL STATEMENTS

standby bond purchase agreement with a commercial bank for each respective tranche. Pursuant to each agreement, the respective bank has agreed to purchase any bonds of that respective tranche that have been tendered for purchase during the term of the agreement.

With regards to the following demand bonds, the issuer has entered into take-out agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

North Carolina State University - General Revenue Bonds, Series 2003B

On June 20, 2003 the University issued tax-exempt variable rate revenue demand bonds in the amount of \$45.66 million that have a final maturity date of October 1, 2027. The bonds are subject to mandatory sinking fund redemption that began on October 1, 2004. The University's proceeds of this issuance were used to pay a portion of the costs of certain improvements on the campus of the University, to refund certain debt previously incurred for that purpose, and to pay the costs incurred in connection with the issuance of the 2003B bonds.

While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the paying agent, The Bank of New York. Upon notice from the paying agent, the remarketing agent, UBS Financial Services Inc., has agreed to exercise its best efforts to remarket the bonds for which a notice of purchase has been received.

Under a Standby Bond Purchase Agreement (Agreement) between the Board of Governors of the University of North Carolina and Bayerische Landesbank, a Liquidity Facility has been established for the Trustee (The Bank of New York) to draw amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase when remarketing proceeds or other funds are not available. This Agreement requires a commitment fee equal to 0.13% of the available commitment, payable quarterly in arrears, beginning on July 1, 2003 and on each October 1, January 1, April 1, and July 1 thereafter until the expiration date or the termination date of the Agreement.

Under the Agreement, any bonds purchased through the Liquidity Facility become Liquidity Provider Bonds and shall, from the date of such purchase and while they are Liquidity Provider Bonds, bear interest at the Liquidity Provider Rate (the greater of the bank prime commercial lending rate and Federal Funds Rate plus 0.5%). Upon remarketing of Liquidity Provider Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Liquidity Provider Bonds. Payment of the interest on the Liquidity Provider Bonds is due the first business day of each month in which Liquidity Provider Bonds are outstanding. At June 30, 2006, there were no Liquidity Provider Bonds held by the Liquidity Facility. The original Liquidity Facility expiration date has been extended and is scheduled to expire on November

30, 2015, unless otherwise extended based on the terms of the Agreement.

Upon expiration or termination of the Agreement, the University is required to redeem (purchase) the Liquidity Provider Bonds held by the Liquidity Facility in twenty quarterly installments, beginning the first business day of January, April, July, or October, whichever first occurs on or following the Purchase Date along with accrued interest at the Liquidity Provider Rate. In the event the entire issue of \$45.07 million of demand bonds was "put" and not resold, the University would be required to pay \$11.22 million a year for 5 years under this agreement assuming an 8.75% interest rate.

University of North Carolina Hospitals - Revenue Bonds, Series 2001A and Series 2001B

On January 31, 2001, the Hospitals issued two series of tax-exempt variable rate demand bonds in the amount of \$55 million (2001A) and \$55 million (2001B) that have a final maturity date of February 15, 2031. The bonds are subject to mandatory sinking fund redemption that began on February 15, 2002. A portion of the proceeds was used to reimburse the Hospitals for \$75 million spent allowing the UNC Health Care System to acquire controlling interest in Rex Healthcare Inc. The remaining proceeds are being used for the renovation of space vacated after the opening of the North Carolina Women's Hospital, North Carolina Children's Hospital, and associated support services. While initially bearing interest in a daily mode, the mode on these bonds may change to a weekly rate, a unit pricing rate, a term rate or a fixed rate.

While in daily mode, the bonds are subject to purchase on any business day upon demand by telephonic notice of tender to the remarketing agent on the purchase date and delivery to the bond tender agent, Wachovia Bank, N.A. The Hospitals' remarketing agents, Merrill Lynch, Pierce, Fenner & Smith Incorporated (Series 2001A) and Banc of America Securities LLC (Series 2001B) have agreed to exercise their best efforts to remarket bonds for which a notice of purchase has been received. The quarterly remarketing fee is payable in arrears and is equal to either 0.05% or 0.08% of the outstanding principal amount of the bonds assigned to each agent, depending upon their performance in comparison to an established benchmark.

Under separate Standby Bond Purchase Agreements for the Series 2001A and Series 2001B (Agreements) between the Hospitals and Landesbank Hessen-Thüringen Girozentrale, a Liquidity Facility has been established for the tender agent to draw amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase when remarketing proceeds or other funds are not available. These Agreements require an adjustable facility fee based on the long-term rating of the bonds, which is calculated as a percentage of the available commitment. Payments are made quarterly in arrears, on the first business day of each July, October, January and April thereafter until the expiration date or the termination date of the Agreements. For the past fiscal year the percentage was 0.25% with the new long-term agreement that became effective

NOTES TO THE FINANCIAL STATEMENTS

on July 11, 2005. The percentage will remain 0.25% unless the bond ratings change.

Under the Agreements, any bonds purchased through the Liquidity Facility become Bank Bonds and shall, from the date of such purchase and while they are Bank Bonds, bear interest at the Formula Rate (Base Rate equal to the higher of the Prime Rate for such day or the sum of 0.5% plus the Federal Funds Rate) subject to a maximum rate as permitted by law. Upon remarketing of Bank Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Bank Bonds. Payment of the interest on the Bank Bonds is due quarterly (the first business day of January, April, July and October) for each period in which Bank Bonds are outstanding. At June 30, 2006, there were no Bank Bonds held by the Liquidity Facility.

Included in the Agreements is a take out provision, in case the remarketing agent is unable to resell any bonds that are "put" within 90 days of the "put" date. In this situation, the Hospitals is required to redeem the Bank Bonds held by the Liquidity Facility. The agreements allow the Hospitals to redeem bank bonds in equal quarterly installments, on the first business day of January, April, July and October. The payments will commence with the first business day of any such month that is at least 90 days following the applicable purchase date of the Bank Bond and end no later than the fifth anniversary of such purchase date. If the take out agreement were to be exercised because the entire outstanding \$104.8 million of demand bonds was "put" and not resold, the Hospitals would be required to pay \$25.79 million a year for 5 years under the installment loan agreement assuming an 8.25% prime interest rate.

The current expiration date of the Agreements is December 31, 2015. The Liquidity Provider has the option to terminate its commitment on October 11, 2008, October 11, 2011, or October 11, 2014 by providing adequate notice of its intention. The Hospitals may request additional extensions of at least one year from the previous termination date. Extensions are at the discretion of Liquidity Provider.

University of North Carolina Hospitals - Revenue Refunding Bonds, Series 2003A and Series 2003B

On February 13, 2003, the Hospitals issued two series of tax-exempt variable rate demand bonds in the amount of \$63.77 million (2003A) and \$34.25 million (2003B) that have a final maturity date of February 1, 2029. The bonds are subject to mandatory sinking fund redemption that began on February 1, 2004. The proceeds were used to advance refund \$88.33 million of the Series 1996 Bonds. While initially bearing interest in a weekly mode, the mode on these bonds may change to a daily rate, a unit pricing rate, a term rate or a fixed rate.

While in the weekly mode, the bonds are subject to purchase on demand with seven days notice to the remarketing agent and delivery to the bond tender agent, Wachovia Bank, N.A. The Hospitals' remarketing agents, Banc of America Securities LLC (Series 2003A) and Wachovia Bank, N.A. (Series 2003B) have

agreed to exercise their best efforts to remarket bonds for which a notice of purchase has been received. The quarterly remarketing fee is payable in arrears and is equal to 0.08% of the outstanding principal amount of the bonds assigned to the remarketing agent for Series 2003A and is equal to 0.07% of the outstanding principal amount of the bonds assigned to the remarketing agent for Series 2003B.

Under separate Standby Bond Purchase Agreements for the Series 2003A and Series 2003B (Agreements) between the Hospitals and Bank of America, N.A. (Series 2003A) or Wachovia Bank, N.A. (Series 2003B) a Liquidity Facility has been established for the Tender Agent to draw amounts sufficient to pay the purchase price on bonds delivered for purchase when remarketing proceeds or other funds are not available. These Agreements require a facility fee equal to 0.22% of the available commitment for Series 2003A and for Series 2003B, payable quarterly in advance, beginning on February 13, 2003, and on each February 1, May 1, August 1, and November 1 thereafter until the expiration date or the termination date of the Agreements.

Under the Agreements, any bonds purchased through the Liquidity Facility become Bank Bonds and shall, from the date of such purchase and while they are Bank Bonds, bear interest at the Bank Bond Interest Rate (for Series 2003A, the rate equals the London Interbank Offered Rate (LIBOR) plus 2.50% for the first 90 days and then equals LIBOR plus 4%; for Series 2003B, the rate equals Prime Rate for the first 90 days and then equals Prime plus 1%) subject to a maximum rate as permitted by law. Upon remarketing of Bank Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Bank Bonds. Payment of the interest on the Bank Bonds is on the first business day of each month for each period in which Bank Bonds are outstanding. At June 30, 2006, there were no Bank Bonds held by the Liquidity Facility.

Included in the Agreements is a take out provision, in case the remarketing agent is unable to resell any bonds that are "put" within 90 days of the "put" date. In this situation, the Hospitals are required to redeem the Bank Bonds held by the Liquidity Facility. The Series 2003A agreement allows the Hospitals to redeem bank bonds in twelve equal quarterly installments beginning on the first February 1, May 1, August 1 or November 1 that occurs at least 90 days following the applicable purchase date of the Bank Bond. If the take out agreement was to be exercised because the entire outstanding \$62.84 million of demand bonds was "put" and not resold, the Hospitals would be required to pay \$24.26 million a year for 3 years under the installment loan agreement assuming a 9.35% interest rate (LIBOR plus 4%). The Series 2003B agreement allows the Hospitals to redeem bank bonds in 36 equal monthly installments, on the first business day of each calendar month after the loan date. Payments commence with the first business day of any such month that is at least 120 days following the applicable purchase date of the Bank Bond. If the take out agreement were to be exercised because the entire outstanding \$33.76 million of demand bonds was "put" and not resold, the Hospitals would be required to pay \$12.93 million a year for

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three years under the installment loan agreement assuming a 9.25% interest rate (Prime plus 1%).

The current expiration date of the Series 2003A Agreement is July 1, 2008 and July 31, 2008 for the Series 2003B Agreement. The Hospitals may request additional extensions, which are approved at the discretion of the Liquidity Provider.

E. Interest Rate and Basis Swaps

Primary Government

Governmental Activities

Objective. As a means to lower its borrowing costs and increase its savings when compared to fixed-rate refunding bonds at the time of issuance in December 2002, the State entered into two interest rate swaps in connection with its \$499.87 million Variable Rate General Obligation Refunding Bonds, Series 2002B-F. The intention of the swap agreements was to effectively change the State's interest rate on the bonds to a synthetic fixed rate of 3.28% (Swap 1) and 3.09% (Swap 2). For comparison, the State sold fixed rate bonds on the same day as the swaps, with the same final maturity, at an interest rate of 4.45%.

In June 2003, the State entered into a third interest rate swap agreement (Swap 3) to lower its borrowing costs and reduce its exposure to variable interest rates in connection with \$355 million Variable Rate Public Improvement Bonds, Series 2002 D, E, F, and G. Effective July 1, 2003, the intention of this third swap agreement was to effectively change the interest rate on the bonds to a synthetic fixed rate of 1.06% (Swap 3) for a period of two years.

In March 2005, the State entered into basis rate swap agreements and related swaptions with three separate counterparties to lower its borrowing costs when compared to fixed rate refunding bonds. The swaption component is disclosed and valued in a separate section within this note (see section F). The bonds associated with basis swaps were as follows (dollars in thousands):

Bonds Associated with Basis Swaps	Principal Amount	Average Coupon	Call Date
Public Improvement, Series 2003A	\$ 171,000	4.89%	3/1/2013
Public Improvement, Series 2003B	169,955	4.87%	4/1/2013
Public Improvement, Series 2004A	335,000	4.86%	3/1/2014
Total	<u>\$ 675,955</u>		

Terms - Swaps 1 and 2. The bonds and the related swap agreements mature on June 1, 2019, (Swap 1) and June 1, 2017, (Swap 2) and the combined swaps' notional amount of \$499.87 million matches the \$499.87 million variable-rate bonds. The swaps were entered into at the same time the bonds were issued (December 2002). Starting in fiscal year 2012 the combined notional value of the swaps and the combined principal amount of the associated debt begin to decline. Under the swaps, the

State pays the counterparties a fixed payment of 3.28% (Swap 1) and 3.09% (Swap 2) and receives a variable payment computed at 64% of the London Interbank Offered Rate (LIBOR). Conversely, the bonds' variable-rate coupons are closely associated with the Bond Market Association Municipal Swap Index (BMA).

Terms - Swap 3. This swap began July 1, 2003, with a notional amount of \$355 million which matches the bonds outstanding, and ended on July 1, 2005. Under Swap 3, the State paid the counterparty a fixed payment of 1.06% and received a variable payment at the BMA.

Terms - 2005 Basis Swaps. The 2005 Basis swap agreements were entered into on March 9, 2005 with an effective date of March 30, 2005. The related bonds have serial maturities with Series 2003A having a final maturity on March 1, 2026, 2003B and 2004A have a final maturity on April 1, 2023, and March 1, 2023 respectively. The basis swap agreements mature on March 1, 2026. The swaps combined notional amount of \$675.96 million matches the \$675.96 million fixed rate bonds. Under the terms of the basis rate swap and swaption agreement, the State will pay the BMA to the counterparties and will receive 70% of LIBOR plus a fixed spread of 69 basis points (41 attributable to basis swap and 28 basis points for the swaption).

Fair value. Because interest rates have risen since execution of swaps 1 and 2, the swaps have positive fair values of \$7.18 million (Swap 1) and \$9.26 million (Swap 2) at June 30, 2006. The 2005 basis rate swaps had valuations at June 30, 2006 of: \$14.06 million (Counterparty 1), \$8.72 million (Counterparty 2), and \$5.7 million (Counterparty 3). The mark-to-market valuations were established by market quotations from the counterparties, representing estimates of the amounts that would be paid for replacement transactions

Credit risk. The swaps' fair value represented the State's credit risk exposure to the counterparty as of June 30, 2006. The State's maximum possible loss is equivalent to the aggregate fair value of the swaps. The current counterparty ratings for each swap are presented in the table below:

Swap Counterparty	Moody's Investors Service	Standard & Poor's	Fitch Ratings
Swap 1	Aa1	AA	AA-
Swap 2	Aaa	AAA	-
Basis Swap Counterparty 1	Aa2	AA-	AA-
Basis Swap Counterparty 2	Aa3	A+	AA-
Basis Swap Counterparty 3	Aaa	AAA	-

To mitigate the potential for credit risk, if the counterparty's credit quality falls to a specified rating, the counterparty will be required to collateralize a portion (up to 100%) of the fair value. For Swap 1, if the counterparty's credit quality falls to A1 as determined by Moody's Investors Service (Moody's) or A+ as determined by either Standard & Poor's (S&P) or Fitch Ratings (Fitch) and their exposure exceeds \$5 million, then the swap will be collateralized by the counterparty with cash, U.S.

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government or agency securities, or other collateral acceptable to the State. For Swap 2, if the credit quality falls to Aa1 (Moody's) or AA+ (S&P) and their exposure exceeds \$10 million, then the swap will be collateralized by the counterparty with cash, U.S. government or agency securities, or other collateral acceptable to the State. For the basis swaps, if the counterparty's credit quality is rated lower than Baa1 (Moody's), BBB+ (S&P), or BBB+ (Fitch) by two of the three rating agencies, then the swap will need to be collateralized by the counterparty with cash, U.S. government or agency securities, or other collateral acceptable to the State (Fitch credit ratings only apply to counterparty 1). If the counterparty is required to collateralize a portion of the derivative, then the collateral will be posted with a third party custodian or secured party.

An additional termination event occurs if the counterparty fails to maintain: for Swap 1, at least two ratings of at least Baa1 (Moody's) or BBB+ (S&P and Fitch); for Swap 2, at least one rating of at least Baa3 (Moody's) or BBB- (S&P). An additional termination event for the basis swaps occurs if counterparty 1 or 3 has one or more issues of rated, unsecured, unenhanced senior debt or long-term deposits outstanding and none of such issues has at least two ratings of at least Baa2 or higher as determined by Moody's, BBB or higher as determined by S&P or BBB or higher as determined by Fitch. For counterparty 2, an additional termination event occurs if it has one or more issues of rated, unsecured, unenhanced senior debt outstanding and none of such issues has at least two ratings of Baa2 or higher (Moody's), BBB or higher (S&P) or counterparty 2 fails to have a rating on long-term, unsecured, unenhanced senior debt.

Basis risk and termination risk. Swaps 1 and 2 expose the State to basis risk should the relationship between LIBOR and BMA converge, changing the synthetic rate on the bonds. The effect of this difference in basis is indicated by the difference between the intended synthetic rates of 3.28% (Swap 1) and 3.09% (Swap 2) and the synthetic rates as of June 30, 2006 of 3.79% (Swap 1) and 3.6% (Swap 2). As of June 30, 2006, the average rate on the State's variable rate bonds was 3.93%, whereas 64% of LIBOR was 3.42%. The swaps may be terminated by the State with 15 days notice and the counterparties can only terminate the swaps if the State's credit rating falls below Baa1 (Moody's), or BBB+ (S&P or Fitch) for Swap 1, and on Swap 2, below Baa3 (Moody's) or BBB- (S&P or Fitch), or an Event of Default occurs.

2005 Basis Swaps: These swaps expose the State to basis risk should the relationship between the two variable indexes BMA and LIBOR converge, which would affect the amount of interest savings realized. The State pays BMA and receives 70% of LIBOR plus 69 basis points (28 basis points relate to swaptions) on the notional amounts by counterparty. As of June 30, 2006, there was no basis risk as the State was paying BMA equal to 3.97% and receiving 4.43% (70% of LIBOR plus 69 basis points). LIBOR is 5.35% at June 30, 2006. The basis swaps and swaptions may be optionally terminated by the State with two days notice for counterparties 1 and 2 or with five days notice for counterparty 3. The counterparties can only

terminate if the State, at any time during the term of the swap transaction, fails to maintain by at least two rating agencies, ratings of at least Baa2 or higher as determined by Moody's, BBB or higher as determined by S&P or BBB or higher by Fitch (Fitch does not apply to counterparty 2).

Market-access risk/Rollover-risk. Swap 1 and Swap 2 are for the term of the Bonds and therefore there is no market-access risk or rollover risk. The 2005 basis rate swaps terminate at approximately the same time as the associated serial bonds mature (March 1, 2026; March 1, 2023; and April 1, 2023) and thus no rollover risk exists.

Business-type Activities

Objective. In order to protect against the potential of rising interest rates, the Town of Butner, State of North Carolina entered into an interest rate swap in connection with its \$9.91 million Butner Water and Sewer System Revenue Bond Series 2001. The intention of the swap agreement was to effectively change the State's interest rate on the bonds to a fixed rate of 4.21% (plus remarketing and liquidity fees and any difference between the variable rate received by the State (65% of LIBOR) and the rate paid by the State on the variable rate bonds).

Terms. The swap agreement with Bank of America, N.A. was effective April 1, 2001, based on a notional amount of \$9.91 million to mature on September 1, 2025. The swap's notional amount of \$9.91 million matches the \$9.91 million variable-rate bonds. Under the swap, the State pays a fixed payment of 4.21% to Bank of America, N.A. and receives a variable payment of 65% of the LIBOR (LIBOR was 5.33% at June 30, 2006). On the other hand, the bond's variable-rate coupons (2.70% at June 30, 2006) are closely associated with the variable BMA, which was 3.97% as of June 30, 2006.

Fair value. Because interest rates have declined since execution of the swap, the swap has a fair value (the State would have to pay the counterparty if the State terminated the swap) of negative \$385 thousand (Bank of America, N.A.) as of June 30, 2006. The swap's negative fair value if terminated may be countered by a reduction in total interest payments required under a new swap creating a lower synthetic fixed rate. Because the coupons on the State's variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The mark-to-market valuations were established by market quotations from the counterparty representing mid-market or average estimates/quotes of the amounts that would be paid for replacement transactions (having the effect of preserving the economic benefit to the party).

Credit risk. As of June 30, 2006, the State was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap becomes positive, the State would be exposed to credit risk in the amount of the derivative's fair value.

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Basis risk and termination risk. The Swap exposes the State to basis risk (including effects of any reduction in marginal tax rates) should the relationship between LIBOR and BMA converge, changing the synthetic rate to the State on the bonds. The effect of this difference in basis is indicated by the difference between the intended synthetic rate of 4.21% and the actual synthetic rate as of June 30, 2006 of 4.71% (0.74% + 3.97%) reflecting a Bond Rate/LIBOR relationship of 17.64% compared to 65% of LIBOR the State is receiving (as of June 30). The swap may be terminated by either party if the other party fails to perform under the terms of the contract. If the swap is terminated, the associated variable-rate bonds would no longer carry synthetic interest rates. Also, if at the time of termination the swap has a negative fair value, the Town would be liable to the counterparty for that amount.

Component Units**University of North Carolina System***University of North Carolina at Chapel Hill*Swap 1

Objective. In order to protect against the risk of interest rate changes, effective October 3, 2000, the University entered into an interest rate swap agreement with Lehman Brothers Special Financing, Inc. (Lehman Brothers) related to \$22 million of The University of North Carolina at Chapel Hill Variable Rate Housing System Revenue Bonds, Series 2000. This series of bonds was refunded in its entirety by the issuance of the University's Variable Rate General Revenue Bonds, Series 2001B (2001B Bonds), and the interest rate swap agreement was amended to reflect the refunding.

Terms. Under this amended agreement, Lehman Brothers pays the University interest on the notional amount based on the BMA on a quarterly basis. On a semiannual basis, the University pays Lehman Brothers interest at the fixed rate of 5.24%. The notional amount of the swap reduces annually in conjunction with the 2001B Bonds; the reductions began in November 2002 and end in November 2025. The swap agreement matures November 1, 2025. As of June 30, 2006, rates were as follows:

	<u>Terms</u>	<u>Rates</u>
Fixed payment to Lehman	Fixed	5.24%
Variable payment from Lehman	BMA	<u>3.61%</u>
Net interest rate swap payments		1.63%
Variable rate bond coupon payments		<u>3.95%</u>
Synthetic interest rate on bonds		<u>5.58%</u>

Fair value. As of June 30, 2006, the swap had a fair value of negative \$2.55 million. The fair value was developed by Lehman Brothers. Their method calculates the future net settlement payments required by the swap assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield

curve for LIBOR due on the date of each future net settlement on the swap.

Credit risk. As of June 30, 2006, the University was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap becomes positive, the University would be exposed to credit risk in the amount of the derivative's positive fair value. Should the swap have a positive fair value of more than \$1 million at that point Lehman would be required to collateralize 103% of their exposure. Lehman Brothers Holdings, guarantor of Lehman Brothers Special Financing, Inc., was rated A1 by Moody's, A+ by S&P, and A+ by Fitch for unsecured long-term debt at June 30, 2006.

Basis risk. The University receives the BMA from Lehman Brothers and pays a floating rate to its bondholders set by the remarketing agent. The University incurs basis risk when its bonds begin to trade at a yield above the BMA. Basis risk also exists since swap payments are made quarterly while bond payments are made monthly. With the alternative tax structure of the swap, a change in tax law would trigger the swap being converted from a BMA swap to a percentage of LIBOR swap. This would introduce basis risk. If the weekly reset interest rates on the University's bonds are in excess of 65% of LIBOR, the University will experience an increase in debt service above the fixed rate on the swap to the extent that the interest rates on the bonds exceed 65% of LIBOR.

Termination risk. The swap agreement uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. Termination could result in the University being required to make an unanticipated termination payment. The swap terminates if the University or Lehman Brothers fails to perform under terms of the contract.

Swap 2

Future swap. The University entered into an interest rate swap agreement with the Bank of New York (BNY) for \$150 million to be effective December 1, 2007. The University has the option to (1) issue variable rate bonds in December 2007, thereby effectively creating synthetic fixed-rate debt, or (2) unwind the swap, capturing the value of the movement of interest rates from the issuance date, and issuing traditional fixed rate bonds.

North Carolina State University

Objective. In order to protect against the potential of rising interest rates, the University entered into three separate pay-fixed, receive-variable interest rate swaps at a cost anticipated to be less than what the University would have paid to issue fixed-rate debt.

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Terms, fair values, and credit risk. The University's swap agreements contain scheduled reductions to outstanding notional amounts that are expected to approximately follow scheduled or anticipated reductions in the associated bonds payable category. The terms, fair values, and credit ratings of the outstanding swaps as of June 30, 2006 were as follows (dollars in thousands).

Associated Bond Issue	Notional Amounts	Effective Date	Fixed Rate Paid	Variable Rate Received	Fair Values	Swap Termination Date	Counterparty Credit Rating Moody's/S&P/Fitch
Centennial Campus 1999A General Revenue 2003B	\$ 8,600	10/1/1999	4.57%	67% of LIBOR	\$(442)	12/01/2019	A1 / AA- / A+
	24,655	6/20/2003	3.54%	BMA ¹	2,045	10/01/2027	Aa1 / AA / AA-
Total	\$33,255				\$1,603		

¹ Variable rate received is the BMA from June 20, 2003 to July 1, 2006; thereafter, the variable rate received will be 75% of LIBOR.

Because rates have changed since the effective dates of the swaps, the 1999A swap has a negative fair value as of June 30, 2006. The negative fair value may be countered by a reduction in total interest payments required under the variable-rate bonds, creating lower synthetic interest rates. Because the coupons on the University's variable-rate bonds adjust to changing interest rates, the bonds do not have corresponding fair value increases. The fair values are the market values as of June 30, 2006.

As of June 30, 2006, the University was exposed to credit risk on the swap with a positive fair value. The State's maximum possible loss is equivalent to the positive fair value of the swap. The swap agreements require termination should the University's or the counterparty's credit rating fall below either Baa2 as issued by Moody's or BBB as issued by S&P or Fitch. Also, under the terms of the swap agreements, should one party become insolvent or otherwise default on its obligations, provisions permit the nondefaulting party to accelerate and terminate all outstanding transactions. To mitigate the potential for credit risk, if the counterparty's credit quality falls below A3 as determined by Moody's or A- as determined by S&P, the swap will be collateralized by the counterparty with cash, U.S. government or agency securities. If the counterparty is required to collateralize, then the collateral will be posted with a third party custodian or secured party. The swap agreements entered into by the University are held with separate counterparties. All the counterparties are rated A1 or better.

Basis risk. The University is exposed to basis risk on the swaps when the variable payment received is based on an index other than BMA. Should the relationship between LIBOR and BMA move to convergence, the expected cost savings may not be realized. As of June 30, 2006, the BMA rate was 3.97%, whereas 67% of LIBOR was 3.57%.

Termination risk. The University or the counterparty may terminate any of the swaps if the other party fails to perform under the terms of the contract. If any of the swaps are terminated, the associated variable-rate bonds would no longer carry synthetic interest rates. Also, if at the time of termination the swap has a negative fair value, the University would be liable to the counterparty for that amount.

Future swap. The University has also entered into an interest rate swap agreement for \$50 million to be effective September 1, 2008, on a General Revenue Bond Issue planned for 2008.

North Carolina Central University

In October of 2003, the North Carolina Capital Facilities Finance Agency issued Student Housing Facilities Revenue Bonds (\$21.48 million Variable Rate Revenue Demand Bonds, Series 2003A). The issuer, the North Carolina Capital Facilities Finance Agency, loaned the proceeds of the Series 2003 Bonds to the NCCU Real Estate Foundation, Inc. (Foundation). The Foundation used the proceeds to finance the costs of building a student housing facility at North Carolina Central University, to fund a debt service reserve fund for the 2003A Bonds, to pay a portion of the interest on the bonds during construction of the project, and to pay certain costs of issuance of the bonds.

Objective. As a means to lower its borrowing costs and increase its savings, when compared against fixed-rate refunding bonds at the time of issuance in October 2003, effective March 24, 2004, the Foundation entered into two interest rate swaps with Wachovia Bank, N.A., in connection with its \$21.48 million Variable Rate Revenue Demand Bonds, Series 2003A. The intention of the swap agreements was to effectively change the interest rate on the bonds to a synthetic fixed rate of 3.52% (Swap 1) and 2.71% (Swap 2).

Terms. The bonds and the related swap agreements mature on October 1, 2024, (Swap 1) and April 1, 2009, (Swap 2) and the combined swaps' notional amount of \$17.18 million hedges 80% of the \$21.48 million variable-rate bonds. The combined notional value of the swaps and the combined principal amount of the associated debt is declining. Under the swaps, the Foundation pays Wachovia Bank, N.A. a fixed rate of 3.52% (Swap 1) and 2.71% (Swap 2) and receives a variable rate at 70% and 100% of LIBOR and BMA, respectively. The bonds' variable-rate coupons are closely associated with the BMA.

Fair value. Because interest rates have risen since execution of the swaps, the swaps have positive fair values of \$361 thousand (Swap 1) and \$244 thousand (Swap 2) as of June 30, 2006. The swaps' positive fair value may be countered by an increase in total interest payments required under the

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variable rate bonds, creating a higher synthetic interest rate. Because the coupons on the Foundation's variable-rate bond are adjusted every seven days to changing interest rates, the bonds do not have a corresponding fair value increase. The mark-to-market valuations were established by market quotations from Wachovia Bank, N.A. representing estimates of the amounts that would be paid upon terminating the transactions.

Credit risk. As of June 30, 2006, the Foundation was exposed to credit risk because the swaps had a positive fair value. The exposed credit risk is in the amount of the derivatives' aggregate fair value. Swap 1 and Swap 2's counterparty (Wachovia Bank, N.A.) was rated Aa2 by Moody's, AA- by S&P and AA- by Fitch at June 30, 2006.

Basis risk and termination risk. Swap 1 exposes the Foundation to basis risk should the relationship between LIBOR and BMA converge, changing the synthetic rate on the bonds. The effect of this difference in basis is indicated by the difference between the intended synthetic rate of 3.52% and the actual rate of 3.76% (Swap 1) at June 30, 2006. As of June 30, 2006, the rate on the Foundation's Bonds was 3.98%, whereas 70% of LIBOR was 3.73%. Swap 2 exposes the Foundation to basis risk should the actual rate on the Foundation's Bond vary from the BMA. The effect of this difference in basis is indicated by the difference between the intended synthetic rate of 2.71% and the actual rate of 2.72% (Swap 2) at June 30, 2006. As of June 30, 2006, the rate on the Foundation's Bonds was 3.98%, whereas the BMA index was 3.97%. Termination could result in the Foundation being required to make an unanticipated termination payment. The swap agreements are terminated if the Foundation or Wachovia Bank, N.A. fails to perform under the terms of the contract.

Market-access risk/Rollover-risk. Swap 1 and Swap 2 expose the Foundation to market-access and rollover risk when the swaps mature on October 1, 2024 and April 1, 2009 respectively. When Swap 1 and Swap 2 mature, the interest rate on the underlying debt will return to a variable rate.

University of North Carolina Hospitals

Objective. In order to protect against the risk of interest rate changes, the Hospitals entered into an interest rate swap contract agreement with Bank of America, N.A. (BOA) on February 13, 2003. The agreement covers the Variable Rate Revenue Refunding Bonds, Series 2003A for \$63.77 million and Series 2003B for \$34.25 million. The 2003 series of bonds partially refunded Fixed Rate Revenue Bonds, Series 1996.

Terms, fair values, and credit risk. Under this agreement, BOA pays the Hospitals interest on the notional amount based on 67% of the arithmetic mean of the USD-LIBOR-BBA (with a designated maturity of one month) on a monthly basis. Also on a monthly basis, the Hospitals pay BOA interest at the fixed rate of 3.48%. No cash was paid or received by the Hospitals upon initiation of the agreement. The notional amount of the swap reduces annually; the reductions began in February 2004 and end in February 2029.

The swap agreement terminates February 1, 2029. As of June 30, 2006, rates were as follows:

	Terms	2003A Rates	2003B Rates
Fixed payment to BOA	Fixed	3.48%	3.48%
Variable payment from BOA	LIBOR	3.49%	3.49%
Net interest rate swap payments		-0.01%	-0.01%
Variable rate bond payments		4.00%	3.95%
Synthetic interest rate on bonds		3.99%	3.94%

The swap agreement has a mark-to-market value of \$3.01 million as of June 30, 2006. BOA develops the mark-to-market value. Their method calculates the present value of the future net settlement payments required by the swap assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for LIBOR due on the date of each future net settlement on the swap.

As of June 30, 2006, the Hospitals are exposed to credit risk equal to the market value of the swap. BOA's current long-term ratings are AA- by Fitch, Aa1 by Moody's, and AA by S&P. At such time that their ratings fall below A3 for Moody's or below A- for S&P, BOA will be required to collateralize a portion of their exposure (up to 100%). The following instruments can serve as eligible collateral: cash, U.S. Treasury obligations, U.S. government agency fixed rate fixed maturity securities, U.S. government agency single class mortgage-backed securities, U.S. Treasury STRIPS and other U.S. government agency mortgage-backed securities. Posted collateral received will be entered in one or more accounts with a domestic office of a commercial bank, trust company or financial institution organized under the laws of the United States (or any state or a political subdivision thereof).

Basis risk. The Hospitals receive 67% of 1-month LIBOR-BBA Index from BOA and pays a floating rate to its bondholders set by the remarketing agent. The Hospitals incurred basis risk at June 30, 2006, because its bonds traded at a yield above 67% of 1-month LIBOR-BBA Index. If the relationship of the Hospitals' bonds trade to a percentage of LIBOR greater than 67%, the Hospitals will experience an increase in debt service above the fixed rate on the swap.

Termination risk. The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The Hospitals or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. If the swap is terminated, the associated variable-rate bonds would no longer carry synthetic interest rates. Also, if at the time of termination the swap has a negative fair value, the Hospitals would be liable to the counterparty for that amount. Termination could result in the Hospitals being required to make an unanticipated termination payment.

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North Carolina Housing Finance Agency

Objective. The Agency has entered into interest rate swaps in connection with its \$78.7 million variable-rate revenue bonds associated with several series in its 1998 Home Ownership Revenue Bond Resolution as a means to lower its borrowing costs when compared against fixed-rate bonds at the time of issuance. The intention of the swap was to effectively lower the Agency's interest rate on the long term bonds to a fixed rate.

Terms and fair value. The terms and fair value of the outstanding swaps as of June 30, 2006 were as follows (dollars in thousands).

Series	Counterparty	Counterparty Credit Rating Moody's/S&P	Notional Amount	Date of Swap	Maturity Date of Swap	Fixed Rate	Fair Values
15	UBS AG	Aa2/AA+	\$19,205	5/8/2003	7/1/2032	3.51%	\$ 685
16	Bank of America, N.A.	Aa2/AA-	19,485	9/16/2003	7/1/2032	3.81%	266
17	Bank of America, N.A.	Aa2/AA-	20,000	12/11/2003	7/1/2032	3.73%	253
18	Goldman Sachs Mitsui Marine	Aa3/AA+	20,000	4/20/2004	1/1/2035	3.29%	1,141
			<u>\$78,690</u>				<u>\$2,345</u>

Under all of the swaps, the Agency pays the counterparties a fixed rate and receives a variable payment computed as 63% of LIBOR, plus 30 basis points. The bonds' variable-rate coupons are based on the BMA, which was 4.05% as of June 30, 2006.

In total, the swaps have a positive fair value of \$2.345 million as of June 30, 2006. Because the coupons on the Agency's variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

Credit risk. All of the Agency's swaps rely upon the performance of the third parties who serve as swap counterparties, and as a result the Agency is exposed to credit risk – i.e., the risk that a swap counterparty fails to perform according to its contractual obligations. The appropriate measurement of this risk at the reporting date is the fair value of the swaps, as shown in the column labeled "Fair Values" in the table above. The Agency is exposed to credit risk in the amount of any positive net fair value exposure to each counterparty. As of June 30, 2006, the Agency was exposed to a total of \$2.345 million of credit risk to 3 counterparties. To mitigate credit risk, the Agency maintains strict credit standards for swap counterparties. Additionally, credit events can trigger certain termination provisions or collateral provisions as outlined in the swap documents.

Basis risk and termination risk. The swaps expose the Agency to basis risk should the relationship between LIBOR and BMA converge, changing the synthetic rate on the bonds. Series 15 swap may be terminated if the counterparty's credit rating falls below A3 as issued by Moody's or A- as issued by Fitch or S&P. For Series 16, 17 and 18, collateral thresholds have been established if the counterparty's ratings reach A2 for Moody's or A for S&P. Series 16, 17 and 18 swaps may be terminated if the counterparty's rating falls below Baa as issued by Moody's or BBB as issued by S&P.

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F. Swaptions

Objective. As a means of lowering its borrowing costs on the existing bonds in the table below and increasing its savings when compared to fixed rate refunding bonds, the State entered into basis swap and swaption contracts with three different financial institutions. Swaptions give the purchaser the right, but not the obligation, to enter into an interest rate swap on a specified future date. These swaptions and the related basis rate swap disclosed previously were entered into as an alternative to a synthetic fixed rate refunding. This swaption alternative provides an annuity to the State (69 basis points total – 28 for the swaptions). The swaptions give each counterparty the option to require the State to enter into pay-fixed, receive-variable interest rate swaps at the various call dates. If the swaptions are exercised, the State would then expect to issue variable-rate refunding bonds sufficient to retire the related issue.

Bond Series	Principal or Notional Amount (dollars in thousands)				Call Date / Swaption Exercise Date
	Counterparty1	Counterparty 2	Counterparty 3	Series Total	
Public Improvement Bonds, Series 2003A	\$ 85,500	\$ 51,300	\$ 34,200	\$ 171,000	3/1/2013
Public Improvement Bonds, Series 2003B	84,977	50,987	33,991	169,955	4/1/2013
Public Improvement Bonds, Series 2004A	167,500	100,500	67,000	335,000	3/1/2014
Total	\$ 337,977	\$ 202,787	\$ 135,191	\$ 675,955	

Terms. The swaption agreements were entered into on March 9, 2005 and mature March 1, 2026. The swaption annuity was based on the total notional amount of \$675.955 million and is tied to the respective bond issues noted above. The counterparties have the right to exercise the swaption agreements 90 days prior to the call date for each series. If exercised, the State will pay the counterparties a fixed rate, and the counterparties will pay the State a variable rate (BMA) based on a declining notional amount that matches the amortization of the associated bonds by series. If the swaptions are exercised, the State intends to issue variable rate bonds in a principal amount to retire the associated bond series. The terms of the swaptions are listed below, which include counterparty credit ratings as of June 30, 2006.

Counterparty	Based on Respective Notional Amounts				Counterparty Credit Rating Moody's/S&P
	Swaption Annuity Payment Received	Fixed Rate Paid by the State	Variable Rate Received by the State		
Counterparty 1	28 Basis Points	4.8%	BMA		Aa2/AA-
Counterparty 2	28 Basis Points	4.8%	BMA		Aa3/A+
Counterparty 3	28 Basis Points	4.8%	BMA		Aaa/AAA

Fair value. As of June 30, 2006, the swaptions had fair values of negative \$10.03 million (Counterparty 1), negative \$5.62 million (Counterparty 2) and negative \$3.66 million (Counterparty 3), which were estimated using the mark to market method. This method of valuation was established by market quotations from the counterparties representing estimates of the amounts that would be paid for replacement transactions. These values reflect a slight decline in interest rates between March 9, 2005, and June 30, 2006, however, only the State has the option to terminate the swaptions. A replacement transaction would generate net present value savings equal to these fair value amounts.

Market-access risk. A small risk exists that the State, for some unforeseen reason, may be unable to issue the variable rate bonds. If the swaptions are exercised and refunding bonds are not issued, the series 2003 A and B and 2004A bonds would not be refunded, the basis rate swaps would continue, and the State would have to pay a termination payment on the swaptions to the counterparties. Termination values will be based on the net present value difference between BMA and 4.8% fixed rate.

NOTES TO THE FINANCIAL STATEMENTS

G. Debt Service Requirements

The following schedules show the debt service requirements for the primary government (governmental activities and business-type activities) and component units (University of North Carolina System, North Carolina Housing Finance Agency, and the State Education Assistance Authority). The debt service requirements of variable rate debt and net swap payments are based on rates as of June 30, 2006 and assume that current interest rates remain the same for their term. As rates vary, variable-rate bond interest payments and net swap payments will vary.

Annual debt service requirements to maturity for general obligation bonds, certificates of participation, revenue bonds, and notes payable are as follows (dollars in thousands).

Primary Government

Governmental Activities							
Fiscal Year Ending June 30	General Obligation Bonds			Certificates of Participation		Lease-Purchase Revenue Bonds	
	Principal	Interest	Interest Rate	Principal	Interest	Principal	Interest
			Sw aps, Net				
2007	\$ 343,615	\$ 268,712	\$ (1,215)	\$ 21,420	\$ 21,648	\$ 10,000	\$ 11,712
2008	342,715	253,461	(1,215)	21,760	20,824	10,000	11,374
2009	339,320	237,177	(1,215)	22,110	19,925	10,000	11,041
2010	339,200	220,893	(1,215)	22,470	18,963	10,000	10,615
2011	339,360	204,143	(1,215)	22,880	18,026	10,000	10,154
2012-2016	1,708,610	770,067	(4,693)	121,475	73,294	50,000	43,665
2017-2021	1,566,240	372,748	(824)	134,460	41,829	78,000	30,116
2022-2026	726,755	83,050	—	87,485	9,525	77,045	5,889
2027-2031	33,000	1,485	—	—	—	—	—
Total	<u>\$ 5,738,815</u>	<u>\$ 2,411,736</u>	<u>\$ (11,592)</u>	<u>\$ 454,060</u>	<u>\$ 224,034</u>	<u>\$ 255,045</u>	<u>\$ 134,566</u>

Fiscal Year Ending June 30	Governmental Activities			Business-type Activities			
	Notes Payable		Interest Rate Sw aps, Net	Revenue Bonds		Notes Payable	
	Principal	Interest		Principal	Interest	Principal	Interest
2007	\$ 26,334	\$ 4,527	\$ 280	\$ 290	\$ 71	\$ 112	\$ —
2008	10,060	1,277	295	280	69	112	—
2009	4,281	801	305	270	66	112	—
2010	2,594	672	320	259	64	112	—
2011	1,779	590	335	248	61	112	—
2012-2016	15,793	1,924	1,910	1,055	260	561	—
2017-2021	—	—	2,380	691	170	336	—
2022-2026	—	—	2,975	235	58	—	—
Total	<u>\$ 60,841</u>	<u>\$ 9,791</u>	<u>\$ 8,800</u>	<u>\$ 3,328</u>	<u>\$ 819</u>	<u>\$ 1,457</u>	<u>\$ —</u>

The general obligation bonds include \$355 million of variable rate debt without interest rate swaps. For this debt, the variable interest rates change on a weekly basis and are based on the rate paid by each bank. The banks base their rate on what they perceive to be the market (7-day) for debt of this type given the credit standing of the unit of government. The general obligation bonds also include \$499.87 million of variable rate debt with interest rate swaps (see Note 7E).

NOTES TO THE FINANCIAL STATEMENTS

Component Units

Fiscal Year Ending June 30	University of North Carolina System						
	Revenue Bonds			Certificates of Participation		Notes Payable	
	Principal	Interest	Interest Rate Sw aps, Net	Principal	Interest	Principal	Interest
2007	\$ 72,764	\$ 91,829	\$ 183	\$ 1,755	\$ 863	\$ 38,344	\$ 4,392
2008	73,980	88,209	177	1,810	1,182	16,864	3,375
2009	76,660	84,728	195	1,870	1,128	17,140	2,779
2010	76,335	81,063	263	1,930	1,064	17,372	2,172
2011	77,810	77,800	254	2,000	989	6,230	1,649
2012-2016	405,350	336,556	1,042	7,350	3,739	3,200	7,324
2017-2021	373,509	247,834	480	2,435	2,858	—	6,903
2022-2026	319,610	167,614	(65)	3,035	2,251	—	6,903
2027-2031	164,985	111,504	(27)	3,820	1,467	—	6,903
2032-2036	378,380	46,053	—	3,785	447	29,500	5,356
Total	<u>\$ 2,019,383</u>	<u>\$ 1,333,190</u>	<u>\$ 2,502</u>	<u>\$ 29,790</u>	<u>\$ 15,988</u>	<u>\$ 128,650</u>	<u>\$ 47,756</u>

Fiscal Year Ending June 30	Revenue Bonds				
	North Carolina Housing Finance Agency			State Education Assistance Authority	
	Principal	Interest	Interest Rate Sw aps, Net	Principal	Interest
2007	\$ 178,050	\$ 73,845	\$ (61)	\$ —	\$ 117,324
2008	74,735	66,879	(62)	—	117,324
2009	36,995	64,668	(61)	—	117,324
2010	38,755	63,101	(61)	—	117,324
2011	39,800	61,376	(55)	—	117,324
2012-2016	225,885	275,739	(212)	540,704	546,804
2017-2021	207,550	217,645	(132)	325,000	415,722
2022-2026	252,290	167,393	(81)	—	352,965
2027-2031	328,120	88,274	(32)	270,000	310,197
2032-2036	168,880	21,972	—	1,422,950	157,733
2037-2041	13,820	1,162	—	—	—
Total	<u>\$ 1,564,880</u>	<u>\$ 1,102,054</u>	<u>\$ (757)</u>	<u>\$ 2,558,654</u>	<u>\$ 2,370,041</u>

For revenue bonds of the University of North Carolina System and the State Education Assistance Authority, the fiscal year 2007 principal requirements exclude demand bonds classified as current liabilities (see Note 7D).

NOTES TO THE FINANCIAL STATEMENTS**H. Bond Defeasances**

The State and its component units have defeased certain bonds through current and/or advance refundings. New debt proceeds from current refundings may be used to repay the old debt immediately while new debt proceeds from advance refundings are placed into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. Since these bonds are considered to be defeased, the liabilities for these bonds have been removed from the government-wide statement of net assets.

Component Units**University of North Carolina System***University of North Carolina at Chapel Hill*

On August 30, 2005, the University issued \$404.96 million in General Revenue and Revenue Refunding Bonds, Series 2005A, with an average interest rate of 4.9%. The refunding component of this bond was used to advance refund \$6.25 million of outstanding Housing System Revenue Bonds, Series 1997A, with an average interest rate of 4.98%; \$9.9 million of Parking System Revenue Bonds, Series 1997A, with an average interest rate of 5.6%; \$8.75 million of Student Fee Revenue Bonds, Series 2000, with an average interest rate of 5.36%; and \$33.31 million of General Revenue Bonds, Series 2001A, with an average interest rate of 5.23%. This advance refunding was undertaken to reduce total debt service payments by \$4.16 million over the next 23 years and resulted in an economic gain of \$3.42 million. At June 30, 2006, the outstanding balance was \$5.85 million for the defeased Housing System Revenue Bonds, Series 1997A; \$9.9 million for the defeased Parking System Revenue Bonds, Series 1997A; \$8.75 million for the defeased Student Fee Revenue Bonds, Series 2000; and \$33.31 million for the defeased General Revenue Bonds, Series 2001A.

State Education Assistance Authority

On October 27, 2005, the Authority issued \$506.3 million in Series 2005A Student Loan Revenue Bonds with an average interest rate of 4.03%. The refunding component of this issue was used for a current refunding of \$12.35 million of outstanding Series 1995A Student Loan Revenue Bonds with an average interest rate of 6.19%. The refunding was undertaken to reduce total debt service payments by \$2.03 million over the next 9 years and resulted in an economic gain of \$1.61 million.

Prior Year Defeasances

During prior years, the State and certain component units defeased certain general obligation and other bonds. For those defeasances involving advance refundings, the proceeds and any securities purchased with the proceeds were placed in an irrevocable trust with an escrow agent in an amount sufficient to provide for all future debt service payments on the refunded bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the government-wide statement of net assets. At June 30, 2006, the outstanding

balance of prior year defeased bonds was \$1.3 billion for the primary government and \$79.1 million for component units.

I. Bond Redemptions

The bond series resolutions for the North Carolina Housing Finance Agency provide for various methods of redemption. Bonds are redeemed at par from prepayments of mortgage loans securing the issues, from unexpended bond proceeds of the issues, or from funds released via the related decreases in the respective debt service reserve requirements. In addition, various bond issues are redeemable at the option of the Agency with premiums ranging up to 2% for up to 12 years after the date of issue.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 8: LEASE OBLIGATIONS—OPERATING AND CAPITAL

The State and its component units have entered into various operating and capital leases for office space and for communications, computer, and other equipment. Any operating leases with scheduled rent increases are considered immaterial to the future minimum lease payments and current rental expenditures. Operating lease payments are recorded as expenditures or expenses of the related funds when incurred. For the year ended June 30, 2006, total operating lease expenditures were \$65.79 million for Primary Government, \$32.17 million for the University of North Carolina System, and \$5.09 million for Community Colleges. Future minimum lease commitments for noncancelable operating leases and capital leases as of June 30, 2006 are as follows (dollars in thousands):

Fiscal Year	Operating Leases			Capital Leases		
	Primary Government	Component Units		Governmental Activities	Component Units	
		University of North Carolina System	Community Colleges		University of North Carolina System	Community Colleges
2007	\$ 49,517	\$ 19,531	\$ 3,997	\$ 988	\$ 11,789	\$ 1,523
2008	36,640	12,254	3,081	966	7,371	1,371
2009	22,473	7,666	2,049	960	7,372	1,216
2010	13,727	5,352	1,678	1,000	6,831	1,141
2011	9,142	3,785	986	1,040	6,636	1,046
2012 - 2016	16,380	6,746	1,119	5,890	30,214	3,894
2017 - 2021	8,293	48	—	7,215	29,724	2,726
2022 - 2026	8,082	26	—	8,830	29,302	1,740
2027 - 2031	8,082	24	—	—	28,979	—
2032 - 2036	8,082	24	—	—	11,682	—
2037 - 2041	8,082	24	—	—	—	—
2042 - 2046	8,082	24	—	—	—	—
2047 - 2051	8,082	24	—	—	—	—
2052 - 2056	1,616	24	—	—	—	—
Total Future Minimum Lease Payments.....	\$ 206,280	\$ 55,552	\$ 12,910	26,889	169,900	14,657
Less: Amounts Representing Interest				10	66,475	4,770
Present Value of Future Minimum Lease Payments				\$ 26,879	\$ 103,425	\$ 9,887

At June 30, 2006, capital assets acquired under capital leases are as follows (dollars in thousands):

	Primary Government	Component Units	
	Governmental Activities	University of North Carolina System	Community Colleges
Buildings.....	\$ 26,745	\$ 100,770	\$ 1,782
Machinery and Equipment.....	298	5,054	2,542
Other.....	—	695	5,200
Less: Accumulated Depreciation...	—	(5,500)	(1,057)
Total Capital Assets.....	\$ 27,043	\$ 101,019	\$ 8,467

NOTES TO THE FINANCIAL STATEMENTS

NOTE 9: INTERFUND BALANCES AND TRANSFERS

A. Interfund Balances**Due To/From Fiduciary Funds**

The General Fund balance of \$42.541 million due to fiduciary funds is composed of \$12.824 million related to local sales taxes collected in the general fund and due to the agency fund, as well as \$29.717 million related to retirement contributions payable to retirement systems at year end. The other balances due to fiduciary funds are related to balances held on behalf of patients at the State's mental health facilities.

The other balances due from fiduciary funds are primarily for services provided to pension and other employee benefit trust funds. Amounts payable to or receivable from fiduciary funds are considered interfund balances in the fund financial statements, but are not reported as internal balances in the government-wide statement of net assets.

Due To/From Other Funds

Balances due to/from other funds at June 30, 2006, consisted of the following (dollars in thousands):

	Due From Other Funds						Total
	General Fund	Highway Fund	Highway Trust Fund	Other Governmental Funds	Unemployment Compensation Fund	Internal Service Funds	
Due To Other Funds							
General Fund.....	\$ —	\$ —	\$ —	\$ 2,970	\$ —	\$ 11,210	\$ 14,180
Highway Fund.....	—	—	105	6,436	—	2,003	8,544
Highway Trust Fund.....	—	75,495	—	—	—	—	75,495
Other Governmental Funds.....	5,687	—	—	34,962	59	1,145	41,853
EPA Revolving Loan Fund.....	—	—	—	—	—	8	8
NC State Lottery Fund.....	—	—	—	13,548	—	78	13,626
Nonmajor Enterprise Funds.....	—	—	—	10	—	35	45
Internal Service Funds.....	3	—	—	1	—	1,220	1,224
Total.....	\$ 5,690	\$ 75,495	\$ 105	\$ 57,927	\$ 59	\$ 15,699	\$ 154,975

These balances resulted primarily from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made. Amounts reported in the funds as interfund receivables and payables were eliminated in the governmental and business-type activities columns of the government-wide statement of net assets, except for the net residual amounts due between governmental and business-type activities, which were presented as internal balances.

NOTES TO THE FINANCIAL STATEMENTS

B. Interfund Transfers

Transfers in/out of other funds for the fiscal year ended June 30, 2006 consisted of the following (dollars in thousands):

Transfers Out	Transfers In							Total
	General Fund	Highway Fund	Highway Trust Fund	Other Governmental Funds	EPA Revolving Loan Fund	Other Enterprise Funds	Internal Service Funds	
General Fund.....	\$ —	\$ 16,966	\$ 1,321	\$ 594,316	\$ 5,306	\$ 2,068	\$ 336	\$ 620,313
Highway Fund.....	41,280	—	—	213,760	—	—	—	255,040
Highway trust fund.....	253,201	68,940	—	102	—	—	—	322,243
Other Governmental Funds.....	329,883	—	—	186,494	3,380	87	1,145	520,989
Unemployment Compensation Fund..	—	—	—	8,300	—	—	—	8,300
EPA Revolving Loan Fund.....	270	—	—	3	—	—	—	273
NC State Lottery Fund.....	17	—	—	63,552	—	—	1,020	64,589
Other Enterprise Funds.....	752	—	—	4,905	—	—	—	5,657
Internal Service Funds.....	129	—	—	31	—	—	—	160
Total.....	<u>\$ 625,532</u>	<u>\$ 85,906</u>	<u>\$ 1,321</u>	<u>\$ 1,071,463</u>	<u>\$ 8,686</u>	<u>\$ 2,155</u>	<u>\$ 2,501</u>	<u>\$ 1,797,564</u>

Transfers are primarily used to (1) transfer revenues and bond proceeds from the fund required by State statute or budget to collect the revenue to the fund required by State statute or budget to expend them, (2) provide unrestricted revenues collected in the general fund to finance operating and capital programs accounted for in other funds in accordance with budgetary authorizations, and (3) reflect reversions of State funds from other funds to the General Fund in accordance with Office of State Budget and Management requirements.

When the Highway Trust Fund was created in 1989, the revenue from the sales tax on motor vehicles was transferred from the General Fund to the Highway Trust Fund. To offset a portion of this revenue loss in the General Fund, the Highway Trust Fund is required to transfer funds to the General Fund each year. The total transfer for this fiscal year was \$252.55 million.

In 1998 a suit was filed by the N.C. School Boards Association, et.al. against Richard H. Moore, State Treasurer, et.al. The court case questioned certain collections received by the Department of Revenue. On July 1, 2005 the Supreme Court concluded that these collections previously recorded as taxes were in fact civil penalties and ordered them paid into the Civil Penalty and Forfeiture Fund (other governmental funds). This resulted in a significant increase of the amount transferred from the General Fund to the Civil Penalty and Forfeiture Fund of approximately \$56.57 million.

In compliance with the North Carolina State Lottery Act, House Bill 1023 [Session Law 2005], all "Net Revenues" of the NC State Lottery Fund are required to be transferred to the Education Lottery Fund (other governmental funds) for educational purposes. The total transfer for this fiscal year was \$63.55 million, as set forth in General Statute 18C-164.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 10: FUND BALANCE RESERVES AND DESIGNATIONS

Reserved Fund Balance. The State's reserved fund balances represent those portions of the fund balances that are either (a) externally restricted for a specific use, (b) not available for appropriation or expenditure because the underlying asset is not an available financial resource for current appropriation or expenditure, or (c) for encumbrances, which represent commitments related to unperformed contracts for services and undelivered goods. The reserved fund balances at June 30, 2006, are (dollars in thousands):

	Governmental Funds				
	General Fund	Highway Fund	Highway Trust Fund	Other Governmental Funds	Total Governmental Funds
Specific encumbrances.....	\$ 31,858	\$ 10,495	\$ —	\$ —	\$ 42,353
Inventories.....	73,343	4,833	—	33,818	111,994
Investments.....	52	—	—	—	52
Permanent investments.....	—	—	—	57,372	57,372
Notes receivable.....	6,578	1,102	107	334,362	342,149
Compensated absences charged to federal projects....	—	31,871	—	—	31,871
Prepaid items.....	—	—	—	991	991
Continuing programs.....	39,076	—	—	—	39,076
Capital projects.....	—	—	—	139,650	139,650
Advance to component unit.....	—	—	3,622	21,742	25,364
Loan and grant commitments.....	—	3,181	—	287,095	290,276
Advance to other funds.....	—	—	—	—	—
Other purposes.....	4,511	2,517	—	28,378	35,406
Total reserved fund balance.	\$ 155,418	\$ 53,999	\$ 3,729	\$ 903,408	\$ 1,116,554

Unreserved Designated Fund Balance. The State's unreserved fund balance designations in the General Fund represent tentative plans for use in a future period. The State's internal governing body (*General Assembly*) establishes restrictions on the use of these assets which are reported as fund balance designations. Fund balance designations in the General Fund are established based on the amount of reserves available as measured on the budgetary basis of accounting and authorized carryforwards for continuing General Fund programs. These designations totaled \$656.73 million at June 30, 2006. As shown in the table below, the fund balance available to be designated was a positive \$1.77 billion on a modified accrual basis at June 30, 2006 (dollars in thousands):

Unreserved Designated Fund Balance	General Fund
Disaster relief.....	\$ 141,712
Repairs and renovations.....	222,229
Higher education.....	49,067
Agriculture.....	5,491
Primary and secondary education.....	37,019
Economic development programs.....	18,323
General government programs.....	25,849
Health and human services programs.....	125,457
Public safety, corrections, and regulation programs.....	28,379
Environment and natural resources.....	3,205
Total designations.....	\$ 656,731
Unreserved fund balance.....	\$ 1,769,780

NOTES TO THE FINANCIAL STATEMENTS

NOTE 11: RETIREMENT PLANS

The State reports ten retirement plans as pension trust funds. Section A of this note describes the seven defined benefit public employee retirement plans and one defined contribution plan administered by the State. The remaining plans, described in Note 12, are defined contribution plans administered by a third party under the auspices of the State. The State may or may not make supplementary contributions to these plans. Although the assets of the administered plans are commingled for investment purposes, each plan's assets may be used only for payment of benefits to the members of that plan and for administrative costs in accordance with the terms of the plan. The plans in this note do not issue separate financial statements, nor are they reported as part of other entities. The financial statements and other required disclosures are presented in Note 15 and in the *Required Supplementary Information* section of this *CAFR*. The State also provides an optional retirement plan for certain university employees and a special separation allowance for eligible sworn law enforcement officers.

A. Plan Descriptions and Contribution Information

1. TEACHERS' AND STATE EMPLOYEES' RETIREMENT SYSTEM

This plan is a cost-sharing, multiple-employer, defined benefit plan established by the State of North Carolina to provide pension benefits for employees of the State, its component units, and local boards of education not in the reporting entity. Membership is comprised of employees of state agencies and institutions, local boards of education, universities and community colleges and certain proprietary component units. At June 30, 2006, the number of participating local boards of education and component unit employers was 194 as shown below:

Local boards of education	115
Community colleges	58
University of North Carolina System	18
Proprietary component units	3

Benefits and administrative expenses are funded by member contributions of 6% of compensation, investment income, and by an actuarially required employer contribution established by legislation. For the fiscal year ended June 30, 2006, the State made the actuarially based required contribution of 2.34% of covered payroll. Benefit and contribution provisions are established by General Statutes 135-5 and 135-8 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

2. CONSOLIDATED JUDICIAL RETIREMENT SYSTEM

This plan is a single-employer, defined benefit plan established by the State of North Carolina to provide pension benefits for employees of the State Judicial System. Membership is comprised of judges, district attorneys and clerks of court. The plan provides retirement, disability and death benefits. Benefits and administrative expenses are funded by member contributions of 6% of compensation, investment income, and by employer contributions. For the fiscal year ended June 30, 2006, the State made a statutory contribution of 12.59% of covered payroll. This was greater than the actuarially required contribution of 12.06%. The difference of .53% was applied against the State's net pension obligation to this plan. Benefit and contribution provisions are established by General Statutes 135-57, 135-58, 135-68 and 135-69 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

3. LEGISLATIVE RETIREMENT SYSTEM

This plan is a single-employer, defined benefit plan established by the State of North Carolina to provide retirement and disability benefits for members of the General Assembly.

The benefit will not be payable while the member is employed in a position making him eligible to participate in either the Teachers' and State Employees' Retirement System, Consolidated Judicial Retirement System or the Local Governmental Employees' Retirement System. Benefits and administrative expenses are funded by member contributions of 7% of compensation, investment income, and by actuarially based employer contributions. For the fiscal year ended June 30, 2006, there was no actuarially based required contribution and none was made. Benefit and actuarially based contribution provisions are established by General Statutes 120-4.21, 120-4.19 and 120-4.20 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

NOTES TO THE FINANCIAL STATEMENTS

OTHER STATE ADMINISTERED SYSTEMS

The State also administers the following pension and retirement plans for persons who are not considered employees of the State or its component units.

4. FIREMEN'S AND RESCUE SQUAD WORKERS' PENSION FUND

This plan is a defined benefit pension plan established by the State of North Carolina to provide pension benefits for all eligible firemen and rescue squad workers. Membership is composed of both volunteer and locally employed firemen and emergency medical personnel who elect membership. At June 30, 2006, there were 1,491 participating fire and rescue units. This is a special funding situation in that the State is not the employer but is legally obligated to contribute to the plan.

Benefits and administrative expenses are funded by a ten dollar monthly contribution by the member, investment income and an actuarially based state appropriation. Benefit and contribution provisions are established by General Statute 58-86 and may be amended only by the North Carolina General Assembly.

5. NORTH CAROLINA NATIONAL GUARD PENSION FUND

This plan is a defined benefit plan established by the State of North Carolina to provide pension benefits for members of the North Carolina national guard. This also is a special funding situation because the State is not the employer, but is legally obligated to contribute to the plan.

Benefits and administrative expenses are funded by an actuarially based state appropriation and investment income. Benefit and contribution provisions are established by General Statute 127A-40 and may be amended only by the North Carolina General Assembly.

6. REGISTERS OF DEEDS' SUPPLEMENTAL PENSION FUND

This plan is a cost-sharing, multiple-employer, defined benefit plan established by the State of North Carolina to provide supplemental pension benefits for all eligible, retired county registers of deeds. Membership is composed of registers who are retired from the Local Governmental Employees' Retirement System or an equivalent local plan and have met the statutory eligibility requirements. At June 30, 2006, there were 100 registers enrolled in the plan with all 100 counties participating. An individual's benefits for the year are calculated as a share of accumulated contributions available for benefits for that year, subject to certain statutory limits. An individual's eligibility is based on minimum years of service as a register with the individual's share increasing with years of service. Because of the statutory limits noted above, not all contributions available for benefits are distributed. The State Treasurer administers the plan and *Section B* of this note describes the accounting and investing for the plan. The State's only cost in the plan is administration.

Benefits and administrative expenses are funded by investment income and 4.5% of the receipts collected by each County Commission under Article 1 of Chapter 161 of the North Carolina General Statutes. The statutory contribution currently has no relationship to the actuary's required contribution. Registers do not contribute. The actuarially required contribution and percentage of that contribution actually made is in the *Required Supplementary Information* section of this report. All benefit and contribution provisions are established by General Statute 161-50 and may be amended only by the North Carolina General Assembly.

NOTES TO THE FINANCIAL STATEMENTS**7. SHERIFFS' SUPPLEMENTAL PENSION FUND**

This plan is a defined contribution plan established by the State of North Carolina to provide supplemental pension benefits for all eligible, retired county sheriffs. Membership is comprised of sheriffs who are retired from the Local Governmental Employees' Retirement System and beneficiaries that meet the statutory eligibility requirements. At June 30, 2006, there were 76 sheriffs and two beneficiaries enrolled in the plan with all 100 of the State's counties eligible to participate.

An individual's benefits for the year are calculated as a share of accumulated contributions available for benefits for that year, subject to certain statutory limits. An individual's eligibility is based on minimum years of service as a sheriff with the individual's share increasing with years of service. Because of the statutory limits noted above, not all contributions available for benefits are distributed. The North Carolina Department of Justice administers the plan. If the plan purchases any investments, they are held as part of the State Treasurer's Investment Pool. *Section B* of this note describes the accounting and investing for the plan. The State's only cost in the plan is administration.

Receipts collected by each county's Clerk of Superior Court under General Statutes 7A-304(a)(3a), along with investment income, support the plan's benefits and administrative expenses. Sheriffs do not contribute to the plan. For the fiscal year ended June 30, 2006, the Clerks remitted \$1.24 million. All benefit and contribution provisions are established by General Statute 143-166 and may be amended only by the North Carolina General Assembly.

8. LOCAL GOVERNMENTAL EMPLOYEES' RETIREMENT SYSTEM

This plan is a cost-sharing, multiple-employer, defined benefit plan established by the State of North Carolina for employees of local governments. Membership is comprised of general employees and local law enforcement officers of participating local governmental entities.

At June 30, 2006, the number of participating local governments was 924, as shown below:

Cities.....	427
Counties.....	100
Special districts.....	397

The plan provides retirement benefits nearly identical to the benefits that accrue to members of the Teachers' and State Employees' Retirement System. This plan also provides disability benefits for members who become totally and permanently disabled from performing their usual job. Benefits and administrative expenses are funded by employee contributions of 6% and actuarially based employer contributions. The annual required contribution (ARC) for all employers was 4.75% of covered payroll for law enforcement officers and 4.28% for general employees and firemen. Actual contributions were 5.27% of covered payroll for law enforcement officers and 4.8% for general employees and firemen. In addition, employers with an unfunded liability, established when the government initially enters the system, must make additional contributions towards that liability. The State's responsibility is administrative only. Benefit and contribution provisions are established by General Statutes 128-27 and 128-30 and may be amended only by the North Carolina General Assembly.

The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains.

NOTES TO THE FINANCIAL STATEMENTS

The following table summarizes membership information by plan at the actuarial valuation date:

	<i>Teachers' and State Employees'</i>	<i>Judicial</i>	<i>Legislative</i>	<i>Firemen's and Rescue Squad</i>	<i>North Carolina National Guard</i>	<i>Registers of Deeds'</i>	<i>Local Governmental</i>
Employee Groups							
Retirees and beneficiaries currently receiving benefits	134,719	449	250	9,495	2,640	79	38,448
Terminated employees entitled to benefits but not yet receiving them	54,003	44	86	151	4,076	1	18,240
Active plan members	321,513	497	170	33,520	5,853	99	123,015
Total	510,235	990	506	43,166	12,569	179	179,703
Date of valuation	12-31-05	12-31-05	12-31-05	6-30-05	12-31-05	12-31-05	12-31-05

B. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND PLAN ASSET MATTERS

BASIS OF ACCOUNTING

The financial statements of these plans are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

INVESTMENTS/SECURITIES LENDING

Pursuant to North Carolina General Statutes, the State Treasurer is the custodian and administrator of the retirement systems. The State Treasurer maintains various investment portfolios in its Investment Pool. The investment balance of each system represents its share of the fair value of the net

assets of the various portfolios within the pool. Additionally, the securities lending balance represents assets occurring from securities lending transactions that result from the systems' participation in the pool. The investments of the State Treasurer and securities lending are fully discussed in Note 3.

C. Actuarial Methods and Assumptions

The latest actuarial valuations are dated December 31, 2005 (June 30, 2005, for Firemen's and Rescue Squad Workers' Fund). The actuarial accrued liability and the schedule of funding progress are presented by system in the *Required Supplementary Information* section of this report. The actuarial value of assets for all systems is based on a five-year smoothed market value. Under this method, realized and unrealized gains and losses on investments are smoothed over five years. Below are listed the various actuarial methods and significant assumptions for these valuations that will be used to determine future annual required contributions.

Retirement System	Valuation Date	Actuarial Cost Method	Amortization Method	Remaining Amortization Period	Period Open/Closed	Asset Valuation Method	Actuarial Assumptions	
							Investment Rate of Return	Projected Salary Increase
Teachers' and State Employees'	12/31/05	Entry age	Level dollar	9 years	Open	5 year smoothed	7.25%	4.50-16.10%
Consolidated Judicial	12/31/05	Projected unit credit	Level percentage	9 years	Open	5 year smoothed	7.25%	5.75-11.75%
Legislative	12/31/05	Projected unit credit	Level dollar	8 years	Open	5 year smoothed	7.25%	7.50%
Firemen's and Rescue Squad	6/30/05	Entry age	Level dollar	9 years	Open	5 year smoothed	7.25%	N/A
North Carolina National Guard	12/31/05	Entry age	Level dollar	9 years	Open	5 year smoothed	7.25%	N/A
Registers of Deeds'	12/31/05	Entry age	Level dollar	N/A	Open	5 year smoothed	7.25%	4.50-14.65%
Local Governmental Employees'	12/31/05	Frozen entry age	Level percentage	Various	Closed	5 year smoothed	7.25%	4.50-14.73%

N/A-Not applicable

NOTES TO THE FINANCIAL STATEMENTS

The valuations for the Teachers' and State Employees' system, Legislative system, and Consolidated Judicial system reflect a 3% cost of living increase for retirees in these systems. The Firemen's and Rescue Squad Workers' Fund increases retirement benefits by \$2 (from \$163 to \$165). The National Guard system increases basic benefits from \$75 to \$80 and total potential benefits from \$150 to \$160. The Local Governmental Employee's system reflects a 2.8% cost of living increase. All of the benefit enhancements listed in this paragraph reflect legislation enacted by the North Carolina General Assembly effective July 1, 2006.

As of this valuation, the unfunded actuarial accrued liability for the Registers of Deeds' system, when amortized over 40 years is less than zero. This situation, which is not allowable under generally accepted accounting principles, is redefined by the actuary to effectively mean there is no liability to be amortized.

The projected investment returns and projected salaries for all systems, except the Legislative, include a 3.75% inflationary factor within the actuarial assumption. The assumption for the Legislative system does not identify an inflationary factor.

CURRENT FISCAL YEAR ASSUMPTIONS

Unless otherwise noted in this footnote or in the required supplementary schedules, the actuarial values, methods and significant assumptions for the current year's required contributions are the same as those presented in the table shown on the prior page. The annual required

contributions (ARC) for the fiscal year ended June 30, 2006, were developed from various prior year valuations. The Teachers' and State Employees', Local Governmental Employees', Consolidated Judicial, and National Guard systems' valuations were as of December 31, 2003, the Legislative system was valued at December 31, 2004, and the Firemen's and Rescue Squad Worker's Fund was valued at June 30, 2004. These valuations used amortization periods of eight years for Legislative and nine years for all the other systems. Registers of Deeds' was valued at December 31, 2003, but effectively had no liability to be amortized. The Local Governmental Employees' system is an aggregate of numerous employers, and consequently, has various amortization periods. The rate of investment return and projected salary increases used in these valuations assumed essentially the same increases as in the most current valuations reported on the prior page.

For the fiscal year ended June 30, 2006, retirees in the Local Governmental Employees' system received a 2.5% cost of living adjustment. The Teachers' and State Employees' system, Legislative Retirement system and the Consolidated Judicial system provided a 2% cost of living increase for retirees. The Firemen's and Rescue Squad Workers' Fund increased retirement benefits from \$161 to \$163. All of these benefit enhancements reflect legislation enacted by the North Carolina General Assembly effective July 1, 2005. These enhancements were either reflected as liabilities in the December 31, 2004, valuations, or the systems paid for them through actuarial gains.

D. Annual Pension Cost and Net Pension Obligation

The annual pension costs and net pension obligations for the State's single-employer and special funding defined benefit plans for the current fiscal year are as follows (dollars in thousands):

	Consolidated Judicial Retirement System	Legislative Retirement System	Firemen's and Rescue Squad Workers' Pension Fund	North Carolina National Guard Pension Fund
Annual required contribution.....	\$ 6,448	\$ —	\$ 7,926	\$ 5,944
Interest on net pension obligation.....	99	(1)	49	(28)
Adjustment to annual required contribution.....	(176)	5	(105)	58
Annual pension cost.....	6,371	4	7,870	5,974
Less: Contributions made.....	6,732	—	7,926	6,042
Increase (decrease) in net pension obligation.....	(361)	4	(56)	(68)
Net pension (asset) obligation beginning of year....	1,368	(21)	676	(386)
Net pension (asset) obligation end of year.....	<u>\$ 1,007</u>	<u>\$ (17)</u>	<u>\$ 620</u>	<u>\$ (454)</u>

NOTES TO THE FINANCIAL STATEMENTS

The following table presents the required three year trend of pension costs for the State's single-employer and special funding defined benefit plans and the annual required contributions (ARC) the State made to the Teachers' and State Employees' Retirement System (the System), a cost-sharing, multiple-employer plan. Except for (A) below, the State's statutory annual contribution to the System equals its total annual payment to the System and equals the State's pension cost in these financial statements. The State does not make any contributions to the Local Governmental Employees' System; therefore, it has no related pension cost.

**State of North Carolina's Annual Pension Cost (APC)
and Annual Required Contributions (ARC) as an Employer**
For the Years Ended June 30, 2004 through June 30, 2006 (dollars in thousands)

	<u>Teachers' and State Employees'</u>	<u>Judicial</u>	<u>Legislative</u>	<u>Firemen's and Rescue Squad</u>	<u>North Carolina National Guard</u>
Primary Government:					
2006	\$ 66,873	\$ 6,371	\$ 4	\$ 7,870	\$ 5,974
2005	59,021	6,432	4	7,460	1,431
2004 (A)	35,762	5,404	6	6,730	1,043
Component units:					
Universities:					
2006	\$ 35,445				
2005	31,037				
2004	3,038				
Community Colleges:					
2006	\$ 14,990				
2005	13,037				
2004	1,211				
Proprietary Funds:					
2006	\$ 481				
2005	410				
2004	38				
Total Primary Government and Component Units:					
2006	\$ 117,789	\$ 6,371	\$ 4	\$ 7,870	\$ 5,974
2005	103,505	6,432	4	7,460	1,431
2004	40,049	5,404	6	6,730	1,043
Percentage of APC Contributed:					
2006		106%	0%	101%	101%
2005		101%	0%	101%	109%
2004		112%	0%	102%	290%
Percentage of ARC Contributed:					
2006	100%				
2005	100%				
2004	100%				
Net Pension (Asset) Obligation:					
2006		\$ 1,007	\$ (17)	\$ 620	\$ (454)
2005		1,368	(21)	676	(386)
2004		1,449	(25)	737	(253)

(A) - The State's contribution/pension cost for the Teachers' and State Employees' Retirement System equals the actuarially required contribution plus \$30 million in additional appropriations mandated by the N.C. General Assembly.

Yearly pension liabilities for the systems are shown in the *Required Supplementary Information* section of this report. Beginning with the accounting transition year of 1997, liabilities were determined in accordance with Governmental Accounting Standards Board Statement No. 27 (GASB 27). As presented here, each system's yearly APC and net pension (asset) obligation were computed retroactively to 1993 in accordance with GASB 27 and contain the cumulative effect of applying that statement.

NOTES TO THE FINANCIAL STATEMENTS**E. Optional Retirement Plan**

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Faculty and administrators with faculty rank in universities of the UNC System may join the Program instead of the Teachers' and State Employees' Retirement System. At June 30, 2006, the Plan had 11,239 participants.

Benefits are provided by means of contracts issued and administered by the privately-operated Teachers' Insurance and Annuity Association and the College Retirement Equities Fund (TIAA/CREF), Valid, Fidelity Investments and Lincoln National Life Insurance Company. Participants' eligibility and contributory requirements are established in General Statutes 135-5.1. Participants contribute 6% of compensation and the university contributes 6.84%. There is no liability other than the universities' required contributions. The universities contributed \$67.09 million for the fiscal year ended June 30, 2006. Annual covered payroll was \$980.88 million and employer contributions expressed as a percentage of annual covered payroll were the required 6.84% for the fiscal year ended June 30, 2006. Employee contributions expressed as a percentage of annual covered payroll were the required 6%, with actual employee contributions of \$58.85 million for the fiscal year ended June 30, 2006.

Participants are vested after five years of service, but the company must return the value of the universities' contributions to the State if termination occurs prior to five years of service. The participant chooses his/her own investment products with the company of choice.

F. Special Separation Allowance

The State provides a special separation allowance (SSA), an agent multiple-employer, defined benefit pension plan, for sworn law enforcement officers as defined by General Statutes 135-1(11b) or General Statutes 143-166.30(a)(4) that were employed by State agencies and component units and retired on a basic service retirement under the provisions of General Statutes 135-5(a). To qualify for the allowance, each retired officer must: (1) have completed 30 or more years of creditable service or have attained 55 years of age and completed five or more years of creditable service; and (2) not have attained 62 years of age; and (3) have completed at least five years of continuous service as a law enforcement officer immediately preceding a service retirement. Each eligible officer is paid an annual separation allowance equal to .85% of the officer's most recent base rate of compensation for each year of creditable service. For the fiscal year ended June 30, 2006, the State and its component units paid \$12.21 million for 897 retired law enforcement officers. These benefits are funded on a pay-as-you-go basis with each employer (the State or component unit) responsible for the benefits to their former employees. There is no statewide administration of the SSA and there is no actuarial valuation performed. Funds for this allowance are appropriated annually in the budget of each affected state agency or paid from the component unit's operations. These benefits are established in General Statute 143-166.41 and may be amended only by the General Assembly.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 12: DEFERRED COMPENSATION PLANS

IRC Section 457 Plan – General Statute 143B-426.24 authorized the creation of the Board of Trustees of the North Carolina Public Employee Deferred Compensation Plan (the Board). The Board was established as an agency of the State to offer the State's permanent employees, university employees, and the employees of certain other component units, a uniform Deferred Compensation Plan (the Plan) in accordance with Internal Revenue Code Section 457. The Plan permits each participating employee to defer a portion of his or her salary until future years by having the funds invested in various instruments that make up the North Carolina Public Employee Deferred Compensation Trust Fund. This fund is held in trust by the Plan for the exclusive benefit of participating employees and their beneficiaries. The deferred compensation is available to employees upon separation from service, death, disability, retirement or financial hardships if approved by the Board. The Board has delegated the general administration of the Plan to a third party but has retained all statutory authority and fiduciary responsibility for major decisions of the Plan. The Plan is reported in the CAFR as a pension and other employee benefit trust fund. All costs of administering and funding the Plan are the responsibility of the plan participants. The Plan's financial statements are available by contacting the N.C. Department of State Treasurer at 325 North Salisbury Street, Raleigh, NC 27603-1385.

IRC Section 401(k) Plan - Effective January 1, 1985, Chapter 135, Article 5 of the General Statutes authorized the creation of the Supplemental Retirement Income Plan of North Carolina (the Plan) in accordance with Internal Revenue Code Section 401(k). All members of the Teachers' and State Employees' Retirement System, Consolidated Judicial Retirement System, Legislative Retirement System, Local Governmental Employees' Retirement System and University Optional Retirement Program are eligible to enroll in the Plan and may contribute up to 20% (limited to an Internal Revenue maximum dollar amount) of their compensation during the plan fiscal year. Members of the Plan may receive their benefits upon retirement, disability, termination, hardship, or death. All contributions and costs of administering the Plan are the responsibility of the participants.

The Plan is a defined contribution pension plan that is administered by a third party contractor. The contractor prepares financial statements based on the Plan's fiscal year. The audited statements for the year ended December 31, 2005, are presented in this financial report as a pension and other employee benefit trust fund. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. The Plan's financial statements are prepared using the accrual basis of accounting. Investments are reported at fair value. Securities and mutual funds are based on published quotations while bank investment contracts are stated at contract value. Notes Receivable represent loans to participants and are reported at outstanding principal balances. Prudential Retirement Services administers the Plan, and the

Plan's financial statements are available by contacting the N.C. 401(k) Plan, 150 Fayetteville Street Mall, Suite 1340, Raleigh, NC 27601.

In addition to the voluntary contribution criteria above, General Statute 143-166.30 requires state contributions to the Plan to provide benefits for all law enforcement officers employed by the State and its component units. General Statute 143-166.50 requires local governmental units with law enforcement officers to also contribute at least as much as the State. Participation begins at the date of employment. State agencies and component units are required to contribute monthly to the individual accounts of participants an amount equal to 5% of each officer's monthly salary. The State is also required to contribute to the individual accounts of all officers on a per capita basis in equal shares. State law enforcement officers receive \$.50 for each court cost assessed and collected under General Statute 7A-304, while \$1.25 of this assessment goes to local law enforcement officers. General Statutes allow law enforcement officers to voluntarily contribute up to 10% of their compensation within any calendar year, but current Internal Revenue Code restrictions limit the actual voluntary contribution a law enforcement officer can make. All contributions are immediately vested in the name of each participant. At December 31, 2005, 45 state agencies and component units along with 465 local governmental units outside our reporting entity contributed the required 5%. In addition, 5 state agencies and 406 local government employers contributed to the Plan on a voluntary basis.

At December 31, 2005, the Plan disclosed the following investments (at fair value) exceeding 5% of the Plan's net assets (in thousands):

Van Kampen Growth and Equity A.....	\$ 642,420
Vanguard Equity Index.....	588,178
Growth Fund of America.....	437,201
Fidelity Intermediate Bond Fund	209,248
Van Kampen Equity Income A	186,999
Oppen Main St Small Cap	127,040
American Europacific Growth.....	122,841

In addition, the Plan owned \$887.71 million of Prudential's Stable Value Fund. This investment exceeded 5% of net assets and is disclosed as a related party transaction because the Prudential Insurance Company is the Plan's contractor. The Plan's remaining investment risks are described in Note 3. The Plan also reported total member contributions of \$221.54 million. The payrolls for law enforcement officers, on which the required contributions were based for the year ended December 31, 2005, amounted to \$142.9 million for the State, \$17.64 million for universities, and \$1.69 million for the other miscellaneous component units. The required 5% employer's contribution was made by the State for \$7.15 million, by universities for \$882 thousand, and by the remaining component units for \$85 thousand. In addition, the State contributed \$565 thousand for the required court cost assessments.

NOTES TO THE FINANCIAL STATEMENTS

IRC Section 403(b) Plans - Employees of the UNC System and community colleges can participate in tax-sheltered annuity contracts and custodial accounts created under Internal Revenue Code (IRC) Section 403(b). Generally all employees are eligible, but the IRC does allow the establishment of a minimum contribution of \$200 and the exclusion from participation of certain classes of employees. Each institution may exclude one or more of these classes if every employee within the institution meeting the class criteria is excluded from participation. The employees' eligible contributions, made through salary reduction agreements, are exempt from federal and state income taxes until the accumulated balances are received or the contributions are withdrawn. Effective January 1,

1989, contributions may be withdrawn by employees only upon separation from service, death, disability, reaching age 59 1/2 or age 55 with qualifying retirement, or due to certain financial hardships. Currently, there is no restriction on the withdrawal of the value of annuity contracts. Custodial accounts established as of December 31, 1988 can be withdrawn only in respect to hardship established as of December 31, 1988. These plans are exclusively for employees of public educational organizations and certain charitable and other non-profit institutions as defined by the IRC. Since all contributions are made voluntarily by employees, all costs are borne by the plans' participants. No direct costs are incurred by the State.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 13: OTHER POSTEMPLOYMENT BENEFITS

A. Health Care for Long-Term Disability Beneficiaries and Retirees

The North Carolina Teachers' and State Employees' Comprehensive Major Medical Plan (the Plan) provides postemployment health insurance to former employees of the State, the University of North Carolina System, community colleges, certain participating proprietary component units, and Local Education Agencies (LEAs) which are not part of the reporting entity. Those former employees who are eligible to receive health care as an other postemployment benefit are long-term disability beneficiaries of the Disability Income Plan of North Carolina (DIPNC) and retirees of the Teachers' and State Employees' Retirement System (TSERS), the Consolidated Judicial Retirement System (CJRS), the Legislative Retirement System (LRS), and the University Employees' Optional Retirement Program (UEORP), with five or more years of contributory membership service in the Retirement System prior to disability or retirement. For the fiscal year ended June 30, 2006, the numbers of participants currently eligible to receive health care as an other postemployment benefit are 53,862 TSERS and DIPNC members (excluding LEA members), 311 CJRS members, 186 LRS members, 1,237 UEORP members, and 75,619 LEA members. The health insurance plan is the same as for active employees as described in Note 14, except that the coverage becomes secondary when former employees become eligible for Medicare.

The funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. These health care benefits are funded by employer contributions that are established in the biennial Appropriations Bill by the General Assembly. The State, participating component units and LEAs contributed a monthly amount equal to 3.8% of active employees' salaries to the Retiree Health Benefit Fund (the Fund). The Fund pays the full cost of coverage for long-term disability beneficiaries and retirees enrolled in the Plan. For the fiscal year ended June 30, 2006, the Fund paid \$2,853 for each Medicare-eligible long-term disability beneficiary and retiree and \$3,748 for each non-Medicare-eligible long-term disability beneficiary and retiree. At June 30, 2006, net assets of the Fund available for future other postemployment benefits for eligible beneficiaries were \$171.13 million.

For the fiscal year ended June 30, 2006, contributions on behalf of former employees were made to the Fund as follows (dollars in thousands):

Primary government	\$	110,766
University of North Carolina System		94,523
Community Colleges		24,342
Certain participating proprietary component units		781
Total contributions by the reporting entity		230,412
Contributions made by LEAs		246,510
Total contributions	\$	476,922

These benefits are established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly.

B. Disability Income

As discussed in Note 14, short-term and long-term disability benefits are provided to the eligible members of the Teachers' and State Employees' Retirement System and the University Employees' Optional Retirement Program through the Disability Income Plan of North Carolina (DIPNC). It is reported in this CAFR as a pension and other employee benefit trust fund. Long-term disability benefits are payable as an other postemployment benefit from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. An employee is eligible to receive long-term disability benefits provided the following requirements are met: (1) the employee has five or more years of contributing membership service in the Teachers' and State Employees' Retirement System of North Carolina (Retirement System) or the University Employees' Optional Retirement Program, earned within ninety-six months prior to the end of the short-term disability period or cessation of salary continuation payments, whichever is later; (2) the employee must make application to receive long-term benefits within 180 days after the conclusion of the short-term disability period or after salary continuation payments cease or after monthly payments for Workers' Compensation cease (excluding monthly payments for permanent partial benefits), whichever is later; (3) the employee must be certified by the Medical Board to be mentally or physically disabled for the further performance of his/her usual occupation; (4) the disability must have been continuous, likely to be permanent, and incurred at the time of active employment; (5) the employee must not be eligible to receive an unreduced retirement benefit from the Retirement System; and (6) the employee must terminate employment as a permanent, full-time employee. An employee is eligible to receive an unreduced retirement benefit from the Retirement System after (1)

NOTES TO THE FINANCIAL STATEMENTS

reaching the age of 65 and completing five years of creditable service, or (2) reaching the age of 60 and completing 25 years of creditable service, or (3) completing 30 years of creditable service, at any age.

The monthly long-term disability benefit is equal to 65% of one-twelfth of an employee's annual base rate of compensation last payable to the participant or beneficiary prior to the beginning of the short-term disability period, plus the like percentage of one twelfth of the annual longevity payment to which the participant or beneficiary would be eligible. The monthly benefits are subject to a maximum of \$3,900 per month reduced by any primary Social Security disability benefits and by monthly payments for Workers' Compensation to which the participant or beneficiary may be entitled, but the benefits payable shall be no less than \$10 a month. When an employee qualifies for an unreduced service retirement allowance from the Retirement System, the benefits payable from DIPNC will cease, and the employee will commence retirement under the Teachers' and State Employees' Retirement System or the University Employees' Optional Retirement Program.

Long-term disability income benefits are advance-funded and actuarially based using the one-year term cost method. Although the DIPNC operates on a calendar year, disability income benefits are funded by employer contributions that are established in the Appropriations Bill by the General Assembly and coincide with the state fiscal year. For the fiscal year ended June 30, 2006, the actuary recommended contribution rate was .52% of member compensation. However, the Appropriations Bill required the State, the University of North Carolina System, community colleges, certain participating component units, and LEAs to contribute .52% of active employees' salaries to fund the disability benefits. The contributions cannot be separated between the amounts that relate to other postemployment benefits and employment benefits for active employees.

At December 31, 2005 (the most recent actuarial valuation date), DIPNC had 5,639 members, including 2,501 LEA members, who were currently eligible to receive disability benefits as an other postemployment benefit out of a total of 332,752 active plan participants. Those individuals who are receiving extended short-term disability benefit payments cannot be separated from the number of members currently eligible to receive disability benefits as an other postemployment benefit.

Actuarial Assumptions for the calendar year endedDecember 31, 2005:

Discount rate	7.25%
Rate of return on investments assumption	7.25%
Projected salary increase assumption	4.5-16.1%
Projected social security benefits	
increase assumption	3.75%
Social security assumption	50%

The required and actual contributions made for the
current fiscal year are as follows (dollars in
thousands):

Annual required contribution for the reporting entity	\$	31,233
Annual required contribution for LEAs		33,733
Total required contributions	\$	64,966
Actual contribution made by:		
Primary Government	\$	14,861
University of North Carolina System		12,934
Community Colleges		3,331
Certain participating		
component units		107
Total actual contribution made by the reporting entity		31,233
Actual contribution made by LEAs		33,733
Total actual contribution made	\$	64,966

The basis for estimating the actuarial liabilities for unpaid claims is discussed in Note 14. The market related actuarial value of the assets of DIPNC at December 31, 2005, was \$279.29 million creating an actuarial deficit of \$39.96 million. The actual fair value of the assets for DIPNC at December 31, 2005 was \$275.07 million. The assets are available for future other postemployment benefits and benefits for eligible active employees.

These benefits are established by Chapter 135, Article 6, of the General Statutes and may be amended only by the North Carolina General Assembly.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 14: RISK MANAGEMENT AND INSURANCE

A. Public Entity Risk Pool

Public School Insurance Fund

The Public School Insurance Fund (the Fund) is a public entity risk pool reported within the enterprise funds. In accordance with Chapter 115C, Article 38, of the General Statutes, the purpose of the Fund is to insure the Local Education Agencies (LEAs), in order to safeguard the investment made in the public schools of North Carolina. The community colleges, which are component units, can also acquire insurance through the Fund as stated in G.S. 115D-58.11(c). The board of each LEA and the board of trustees of each community college are required to carry extended coverage against fire and lightning damage to the extent of not less than seventy-five percent (75%) of the current value for each insurable building. Additionally, the boards are to insure adequately the equipment and contents of said building. The Fund is financed by premiums collected from the LEAs and the community colleges and interest is earned on the Fund's cash balance. Each board has to give notice of its election to insure in the Fund at least 30 days prior to such insurance becoming effective and shall furnish to the State Board of Education a full and complete list of all outstanding fire insurance policies. While the said insurance policies remain in effect, the Fund shall act as coinsurer of the properties covered by such insurance. The Fund currently insures 98 out of 115 LEAs and 28 out of 58 community colleges.

Claim liabilities are based on estimates of the ultimate cost of losses that have been reported but not settled. There are no salvage claims anticipated since any salvage is adjusted in the claim settlement. There are no subrogation claims pending. Since claims are reviewed by adjusters and the actual loss projection is computed in a short time after the claim is reported, the claim adjustment expense associated with the unpaid claim liability will be reflected in the current period. The Fund does consider investment income in determining if a premium deficiency exists.

The only acquisition costs are related to proposal costs and inspection costs for new insurance. Since the Fund can only insure the LEAs and the community colleges, new contracts are immaterial. Since existing contracts are renewed once a year, the Fund's costs are for policy maintenance. Therefore, acquisition costs do not need to be amortized.

The following schedule shows the changes in the reported liability for the past two years (dollars in thousands):

	Fiscal Year	
	2006	2005
Unpaid claims at beginning of year ...	\$ 1,229	\$ 3,947
Incurred claims:		
Provision for insured events		
of the current year	3,273	3,239
Increases (decreases) in provision		
for insured events of prior years	(177)	(417)
Total incurred claims	3,096	2,822
Payments:		
Claims attributable to insured		
events of the current year	2,326	2,552
Claims attributable to insured		
events of the prior years	1,203	2,988
Total payments	3,529	5,540
Total unpaid claims at end		
of the year	\$ 796	\$ 1,229

With the collection of premiums from the insured educational units, payment of valid claims becomes the responsibility of the Fund. All claims greater than \$10 million per occurrence are covered by reinsurance policies. Maximum recoverable from reinsurance for any one catastrophic event is \$45.5 million per occurrence. Annual aggregate limits of \$15 million apply separately with respect to flood and earthquake. Coverage applies to all "all risk" perils. Boiler and machinery coverage is provided under separate contract underwritten by the Fund. Incurred losses are reduced by estimated amounts recoverable under the Fund's reinsurance policies. Currently, there are no claims for reinsurance.

B. Employee Benefit Plans

1. State Health Plan

In accordance with Chapter 135, Article 3, Part 3, of the General Statutes, the State established the North Carolina Teachers' and State Employees' Comprehensive Major Medical Plan, referred to as the State Health Plan (the Plan). The Plan provides comprehensive major medical care benefits for employees and retirees of the State and its participating component units, as well as their qualified dependents on a contributory basis. This care is also extended to employees and retirees of the Local Education Agencies (LEAs), and other employing units allowed by statute, which are not part of the State's reporting entity. Coverage is self-funded by contributions to the Plan, which is reported as a pension and other employee benefit trust fund. Contributions for employee

NOTES TO THE FINANCIAL STATEMENTS

and retiree coverage are made by the State, its participating component units, LEAs, and other qualified employing units. Contributions for dependent coverage are made by employees and retirees. As described in Note 13, coverage is also extended to certain individuals as an other postemployment benefit. The Plan has contracted with third parties to process claims.

The Plan pays most expenses that are medically necessary and eligible for coverage based on usual, customary and reasonable allowances. Claims are subject to specified annual deductible and co-payment requirements. The Plan disallows claims in excess of a lifetime maximum of \$5 million.

Claim liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported). Changes in the Plan's aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
2004-05	\$ 166,672	\$ 1,728,605	\$ (1,663,314)	\$ 231,963
2005-06	231,963	1,698,407	(1,759,906)	170,464

2. Death Benefit Plan of North Carolina

Term life insurance (death benefits) is provided through the Death Benefit Plan, a pension and other employee benefit trust fund, to all members of the Teachers' and State Employees' Retirement System who have completed at least 12 consecutive months of membership in the System. Membership includes employees of the State, the University of North Carolina system, community colleges, and certain participating proprietary component units and Local Education Agencies (LEAs) which are not part of the reporting entity. The benefit payment is equal to the greater of (1) the compensation on which contributions were made by the member during the calendar year preceding the year in which his/her death occurs or (2) the member's highest twelve month's salary in a row during the twenty-four months prior to his/her death. The benefit is subject to a minimum of \$25,000 and to a maximum of \$50,000.

For the period July 1, 2005 to June 30, 2006, death benefits were funded by actuarially based employer contributions that are established in the biennial appropriation bill by the General Assembly. The State, the University of North Carolina system, community colleges, and certain participating proprietary component units and LEAs contributed .16% of active employees' salaries to fund the Death Benefit Plan for the period July 2005 to June 2006.

These benefits are established by Chapter 135, Section 5(1), of the General Statutes and may be amended only by the North Carolina General Assembly. Claims liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported).

Changes in the aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
2004-05	\$ 1,909	\$ 31,222	\$ (30,865)	\$ 2,266
2005-06	2,266	26,412	(25,931)	2,747

3. Disability Income Plan of North Carolina

Short-term and long-term disability benefits are provided through the Disability Income Plan of North Carolina (DIPNC), a pension and other employee benefit trust fund, to the eligible members of the Teachers' and State Employees' Retirement System which includes employees of the State, the University of North Carolina system, community colleges, certain participating proprietary component units, and Local Education Agencies (LEAs) which are not part of the reporting entity, and the University Employees' Optional Retirement Program. Short-term benefits are payable after a waiting period of 60 continuous calendar days from the onset of disability, which is determined as the last actual day of service or the day succeeding at least 365 calendar days after the commencement of service, whichever is later. Short-term benefits are provided to currently active employees and the related liability is not measurable. As discussed in Note 13, long-term disability benefits are payable as an other postemployment benefit from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. These benefits are established by Chapter 135, Article 6, of the General Statutes and may be amended only by the North Carolina General Assembly.

Claim liabilities for long-term disability benefits are actuarially estimated using the one-year term cost method. These liabilities represent the present value of future claim payments obligated to members who have become disabled. The claim liabilities are separated into the following two classifications: (1) approved claim liabilities are for long-term disabilities that have occurred, have been approved, and are in long-term payment status; and (2) incurred but not reported (IBNR) liabilities are for disabilities that have occurred but are not in payment status. The IBNR liabilities are estimated based on the historical claims experience of DIPNC.

Significant actuarial assumptions used to estimate claim liabilities are presented in Note 13. Changes in the aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
2004-05	\$ 281,133	\$ 63,653	\$ (53,591)	\$ 291,195
2005-06	291,195	87,884	(59,836)	319,243

NOTES TO THE FINANCIAL STATEMENTS

C. Other Risk Management and Insurance Activities**1. Automobile, Fire and Other Property Losses**

The State is required by Chapter 58, Article 31, Part 50, of the General Statutes to provide liability insurance on every state-owned motor vehicle, which includes vehicles held by the State's participating component units. The State is self-insured for the first \$500,000 of any loss through a retrospective rated plan. The plan purchases excess insurance through a private insurer to cover losses greater than \$500,000. The liability limits for losses incurring in-state are \$500,000 per claimant and \$5 million per occurrence. For losses incurring out-of-state, the limits are \$1 million per claimant and \$5 million per occurrence. Covered losses include those that occur with vehicles that are not on a stationary track or rail, and federal vehicles when the Governor calls out the National Guard.

Agencies of the State and participating component units using state cars are charged premiums to cover the cost of the excess insurance and to pay for those losses falling under the self-insured retention. Premiums charged are also based on the projected losses to be incurred. The private insurer processes all claims and sets up a reserve for amounts expected to be paid for claims. Claims are paid by the private insurer after they are approved by the Attorney General's Office. Settled claims have not exceeded coverage in any of the past three fiscal years.

The State Property Fire Insurance Fund (the Fund), an internal service fund of the State, was created by Chapter 58, Article 31, of the General Statutes. The Fund insures State owned buildings and contents for fire, extended coverage, and other property losses. The Fund does not charge premiums for fire insurance for operations that are supported by the State's General Fund. Those operations that are not supported by the State's General Fund are charged for fire coverage. Agencies of the State can purchase extended coverage and other property coverage such as sprinkler leakage, business interruption, vandalism, theft, and "all risk" for buildings and contents through the Fund. For those that elect to receive any of this other coverage, the Fund charges premiums discounted from industry manual rates. The Fund insures losses up to \$2.5 million per occurrence. All losses covered by the Fund are subject to a \$500 per occurrence deductible except for theft, which carries a \$1,000 per occurrence deductible. However, some agencies have chosen a higher deductible for a reduction in premium.

The Fund purchases excess insurance from private insurers to cover losses over the amounts insured by the Fund. If aggregate uninsured losses sustained by the Fund, in excess of \$50,000 per loss, other than flood and earthquake losses and wind losses by named storms, reach \$5 million in any one annual period, the Fund's deductible for the remainder of the annual period is \$100,000 per occurrence. Settled claims have not exceeded coverage in any of the past three fiscal years.

Claims of \$10,000 or higher are paid when the Council of State approves the request for payment. Claims less than \$10,000 are paid without Council of State approval. Claims costs are recognized when they are approved by the Council of State and are outstanding for payment; when known estimates of losses are waiting to be submitted to the Council of State for approval; or when a loss occurs and can be reasonably estimated. Claims payable at June 30, 2006 are disclosed on the balance sheet as claims payable. Changes in the balances of claims liabilities for the past two fiscal years are as follows (dollars in thousands):

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
2004-05	\$ 1,227	\$ 1,451	\$ (997)	\$ 1,681
2005-06	1,681	1,242	(1,863)	1,060

NOTES TO THE FINANCIAL STATEMENTS

2. Medical Malpractice Protection**a. Professional Liability Insurance for State Medical Personnel**

All agencies of the State and participating component units are insured for tort claims up to \$500,000 under the authority of the State Tort Claims Act, Chapter 143, Article 31, of the General Statutes. Organizations within the reporting entity carry excess commercial liability insurance to supplement the coverage provided by the State Tort Claims Act; however, claims involving medical malpractice are generally excluded from this coverage. The University of North Carolina at Chapel Hill Medical School (UNC-CH Medical School) and UNC Hospitals participate in the Liability Insurance Trust Fund, which is described in detail below. All other universities purchase commercial liability insurance. Chapter 237, Section 11.33, of the 1999 Session Laws of North Carolina authorized the Department of Health and Human Services, the Department of Environment and Natural Resources, and the Department of Correction to provide medical liability coverage on behalf of employees licensed to practice medicine or dentistry; all licensed physicians who are faculty members of the University of North Carolina who work on contract for the Division of Mental Health, Developmental Disabilities, and Substance Abuse Services for incidents that occur in Division programs; and on behalf of medical residents from the University of North Carolina who are in training at institutions operated by the Department of Health and Human Services. The extent of coverage is a maximum of \$1 million for each individual incident and does not affect current coverage under the State Tort Claims Act. The Department of Health and Human Services, the Department of Environment and Natural Resources, and the Department of Correction purchase commercial professional liability insurance for their medical staff. Settled claims have not exceeded coverage in any of the past three fiscal years.

Insurance coverage varies depending upon the amount of coverage and the type of policy. Typically the amount of primary coverage for medical liability is \$1 million per individual, claim, or incidence, and \$3 million total or aggregate. Many departments and institutions maintain excess policies to provide additional coverage above that provided by the primary policy for medical liability. The policies are written on a claims made or occurrence basis, with the majority of the policies being claims made. The claims liabilities are not measurable.

b. Self-Insurance through the Liability Insurance Trust Fund

The Liability Insurance Trust Fund (Trust Fund) was created by Chapter 116, Article 26, of the General Statutes and the University of North Carolina Board of Governors Resolution of June 9, 1978, to provide medical malpractice protection for program participants and individual health care practitioners working as employees, agents, or officers of the program participants. The program participants are the University of North Carolina Hospitals at Chapel Hill and the

University of North Carolina at Chapel Hill Physicians and Associates, both of whom are a part of the University of North Carolina system, which is a component unit of the reporting entity. Coverage is self-funded by contributions from participants and investment income. Contributions are based on the actuarially determined funding level for a given plan year.

For the period July 1, 2005 through June 30, 2006, the Trust fund provided coverage on an occurrence basis of \$3 million per individual and \$7 million in the aggregate per claim. At May 1, 2005 through June 30, 2006, the Trust Fund provided coverage on an occurrence basis of \$7 million per individual for each and every claim, self-insured through the Trust Fund. Effective July 1, 2005 through June 30, 2006, the Trust Fund entered into an excess of loss agreement with an unaffiliated reinsurer. Reinsurance coverage under this policy carries a \$10 million aggregate limit in excess of a self-insured aggregate of \$33 million subject to a \$7 million per occurrence limit (sub-limit of \$3 million per individual) with a \$200,000 continuing underlying amount per claim. For losses occurring during the period May 1, 2004 through June 30, 2005, the Trust Fund retained 100% of the liability.

The Trust Fund purchased a primary policy for dental residents on a claims made basis with \$1 million per occurrence and \$3 million annual aggregate limits of coverage. In the event the Trust Fund has insufficient funds to pay existing and future claims, it has the authority to borrow necessary amounts up to \$30 million. Any such borrowing would be repaid from the assets and revenues of program participants. No borrowings have been made under this authority to date.

The Trust Fund establishes claim liabilities based on estimates of the ultimate cost of all losses and loss adjustment expenses, including losses and loss adjustment expenses incurred but not yet reported, which are unpaid at the balance sheet date. The claims liabilities of \$48.178 million and \$52.230 million are the present values of the aggregate actuarially determined claims liabilities of \$48.768 million and \$55.296 million, discounted at 3% at June 30, 2005 and 5% at June 30, 2006, respectively. These estimates are reviewed annually, and as adjustments become necessary, such adjustments are reflected in current operations. Claims against participants are paid from the corpus of the Trust Fund. Changes in the Trust Fund's aggregate liabilities for claims for the past two fiscal years are as follows (dollars in thousands):

	Beginning of Fiscal Year Liability	Current-Year Claims and Changes in Estimates	Claim Payments	Balance at Fiscal Year-End
2004-05	\$ 38,085	\$ 18,120	\$ (8,027)	\$ 48,178
2005-06	48,178	10,453	(6,401)	52,230

NOTES TO THE FINANCIAL STATEMENTS

3. Public Officers' and Employees' Liability Insurance

In accordance with Chapter 58, Article 32, Part 15, of the General Statutes, public officers' and employees' liability insurance is provided by private insurers for all employees of the State and participating component units except for doctors and dentists. The policy provides \$5 million excess insurance over the \$500,000 statutory limit payable for any one claim under the State Tort Claims Act. The first \$150,000 of an award against a state agency is the responsibility of the state agency's general fund budget code or up to \$500,000 if a non-general fund budget code. For general fund budget codes, any award greater than \$150,000 but less than \$500,000 is funded by proportionate shares of estimated lapse salaries from all agencies general fund budget codes. Since State agencies and component units are responsible for funding any tort claims of \$500,000 or less from their budget and/or lapse salaries, total claims liabilities are not measurable. Employers are charged a premium for the excess insurance based on a composite rate. The employers pay the premiums directly to the private insurer. Settled claims have not exceeded coverage in any of the past three fiscal years.

4. Employee Dishonesty and Computer Fraud

Blanket public employee dishonesty and computer fraud insurance is provided for agencies of the State and its component units with a limit of \$5 million per occurrence, subject to a \$50,000 deductible and a 10% participation in each loss above the deductible. This coverage is placed with a private insurance company and is handled by the North Carolina Department of Insurance. Agencies of the State and its component units are charged premiums by the private insurance company. A small number of State agencies and component units of the State require faithful performance coverage in addition to employee dishonesty coverage. In these instances, separate policies have been purchased. The amounts of coverage and the deductibles vary among these separate policies. Settled claims have not exceeded coverage in any of the past three fiscal years.

5. Statewide Workers' Compensation Program

The Workers' Compensation Program (the Program) was created by Chapter 97, Article 1, of the General Statutes to provide benefits to workers injured on the job. All employees of the State and its component units are included in the Program. An injury is covered under workers' compensation if it is caused by an accident that arose out of and in the course of employment. Also, certain occupational diseases specifically designated in the North Carolina Workers' Compensation Act are compensable. Losses payable by the Program include medical claims, loss of wages, disability, and death benefits. Payments of all medical benefits are subject to approval based on a fee schedule established by the North Carolina Industrial Commission (NCIC). Loss of wages and disability benefits are payable based on 66 2/3% of an employee's average weekly

salary subject to a statutory compensation rate minimum and maximum established annually by the NCIC. Death benefits are payable for 400 weeks at 66 2/3% of an employee's average weekly salary. In certain instances, death benefits may be extended beyond the 400 weeks.

The responsibility for claiming compensation is on the injured employee. If the injured employee or his representative does not notify the employer within 30 days from the date of injury, the employer can refuse compensation. A claim must be filed with the NCIC by either the employee or the employer within two years from the date of knowledge thereof; otherwise the claim is barred by law and no further compensation is allowable. When an employee is injured, the employer's primary responsibility is to arrange for and provide the necessary treatment for any work-related injury. The employer tries to provide the best possible medical care for injured employees to help them reach maximum medical improvement and return to work as soon as possible.

The State and its component units are self-insured for workers' compensation. A third-party administrator handles workers' compensation claims except for the Department of Transportation. State agencies and participating component units contribute to a fund administered by the Office of the State Controller to cover their workers' compensation claims. The third party administrator receives a per case administration fee and draws down State funds to make medical and indemnity payments on behalf of the State in accordance with the North Carolina Workers' Compensation Act.

Each state agency and participating component unit is responsible for paying claims out of its individual budget. Budgets for workers' compensation for most State agencies and participating component units are based on the prior year's loss experience. Since the related liability is not measurable, claim costs are recognized when paid. The Department of Transportation is the only state agency that sets up a reserve for claims. For the year ended June 30, 2006, workers' compensation costs were recognized as follows (dollars in thousands):

Primary government	\$ 33,000
University of North Carolina System	2,283
All other component units	4
Total	<u>\$ 35,287</u>

NOTES TO THE FINANCIAL STATEMENTS

6. Workers' Compensation Fund

The Workers' Compensation Fund (the Fund) is an insurance enterprise reported within the enterprise funds. The Fund is created in the Department of Insurance (the Department) and is administered by the State Fire and Rescue Commission (the Commission) through a service contract with a third-party administrator. In accordance with Chapter 58, Article 87, of the General Statutes, the purpose of the Program is to provide workers' compensation benefits to members of "eligible units," which consist of volunteer fire departments or volunteer rescue/EMS units that are not part of a unit of local government and are exempt from State income tax under G.S. 105-130.11. These eligible units are not part of the reporting entity. Benefits are payable for compensable injuries or deaths which occurred on or after July 1, 1996. The Fund is financed by appropriations made to the Department for this purpose and by per capita fixed dollar amounts for each member of a participating eligible unit's roster. The per capita fixed dollar amount is set annually by the Commission and is paid by the eligible units to the Commission on or before July 1 of each year for credit to the Fund. If payment is not received by July 1, the eligible unit shall not receive workers' compensation coverage for that fiscal year. The appropriation for the fiscal year ended June 30, 2006 was \$2 million. As of June 30, 2006, the Fund consisted of 1,239 eligible units representing approximately 43,027 members.

The liability for unpaid claims is based on an actuarial determination and represents a reasonable estimate of the ultimate cost of open claims and claim settlement expenses that are unpaid as of the fiscal year end, including incurred but not reported losses. The liability for unpaid claims is continually reviewed, and as adjustments become necessary such adjustments are included in current operations. The Program considers anticipated investment income in determining if a premium deficiency exists. The Program recognizes subrogation from third parties as a reduction to claim and claim settlement expenses incurred. As of June 30, 2006, there was no reduction for subrogation.

Acquisition costs consist of commission payments to independent insurance agents for marketing, promotional and administrative assistance with policy maintenance to eligible units. As coverage is renewed annually, acquisition costs are not amortized.

The Program maintains both specific excess of loss and aggregate reinsurance coverage. The specific excess of loss coverage provides for statutory limits above the Program's retention of \$500,000 per occurrence and a \$1.5 million limit for employer's liability above the Program's retention of \$500,000 per occurrence. Incurred losses are reduced by estimated amounts recoverable under the Program's excess of loss and aggregate reinsurance policies. As of June 30, 2006, there are claims recoverable from reinsurers in the amount of \$816,219.67.

The following schedule shows the changes in the reported liability for the past two fiscal years (dollars in thousands):

	Beginning of Fiscal Year Liability	Current-Year Claims and Changes in Estimates	Claim Payments	Balance at Fiscal Year-End
2004-05	\$ 9,786	\$ 5,594	\$ (5,266)	\$ 10,114
2005-06	10,114	6,715	(5,656)	11,173

7. Health Insurance Program for Children

The Health Insurance Program for Children (the Program) is an insurance enterprise reported within the general fund. The Program was created by Chapter 108A, Article 2, Part 8, of the General Statutes to provide comprehensive health insurance coverage to uninsured low-income children who are residents of this State, including coverage for dental, hearing, and vision services and supplies.

Coverage is provided from federal funds received, State funds appropriated, and other nonappropriated funds made available for this purpose. All appropriations, allocations, premium receipts, or any other receipts, including earnings on investments, occurring or arising in connection with acute medical care benefits provided under the Program are deposited into the Child Health Insurance Fund (the Fund). Disbursements from the Fund include any and all amounts required to pay the benefits and administrative costs of the Program. For the fiscal year ended June 30, 2006, \$68.16 million was appropriated from the General Fund to the North Carolina Department of Health and Human Services (DHHS) to be used for the Program.

The Program is administered by DHHS. Eligible children may be enrolled by the Division of Social Services based on the availability of funds. The North Carolina Teachers' and State Employees' Comprehensive Major Medical Plan (The Plan) is responsible for the administration and processing of claims for benefits under the Program, as provided under Chapter 135, Article 3, Part 5 of the General Statutes. The Plan's self-insured indemnity program shall not incur any financial obligations for the program in excess of the amount of funds that the Plan's self-insured indemnity program receives for the program.

NOTES TO THE FINANCIAL STATEMENTS

Annual enrollment fees, co-payments, or other cost-sharing charges are determined by family income. However, there are no enrollment fees, deductibles, co-payments, or other cost-sharing charges for families covered under the Program whose family income is at or below 150% of the federal poverty level. A family's total annual aggregate cost-sharing charges shall not exceed five percent of the family's income for the year involved. The program had an enrollment of 109,466 children as of June 30, 2006, and an average enrollment of 118,965 children insured during the year.

Claim liabilities are based on estimates of the ultimate cost of claims that have been incurred (both reported and unreported). The following schedule shows the changes in the claims liability for the Program's past two years of operation (dollars in thousands):

	<i>Beginning of Fiscal Year Liability</i>	<i>Current-Year Claims and Changes in Estimates</i>	<i>Claim Payments</i>	<i>Balance at Fiscal Year-End</i>
2004-05	\$ 22,334	\$ 250,719	\$ (240,700)	\$ 32,353
2005-06	32,353	223,718	(235,070)	21,001

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NOTES TO THE FINANCIAL STATEMENTS

NOTE 15: INDIVIDUAL PLAN FINANCIAL STATEMENTS – PENSION AND OTHER EMPLOYEE BENEFIT TRUST FUNDS

Financial statements for Pension and Other Employee Benefit Trust Funds as of and for the fiscal year ended June 30, 2006 are presented below.

COMBINING STATEMENT OF PLAN NET ASSETS

June 30, 2006

(Dollars in Thousands)

	Teachers' and State Employees' Retirement System	Consolidated Judicial Retirement System	Legislative Retirement System	Firemen's and Rescue Squad Workers' Pension Fund	North Carolina National Guard Pension Fund	Local Governmental Employees' Retirement System	401(k) Supplemental Retirement Income Plan
Assets							
Cash and cash equivalents.....	\$ 54,258	\$ 1,851	\$ 115	\$ 1,119	\$ 1,437	\$ 24,177	\$ 13
Investments:							
Annuity contracts.....	—	—	—	—	—	—	887,710
Mutual funds.....	—	—	—	—	—	—	2,439,263
State Treasurer investment pool.....	51,734,288	401,294	30,066	301,675	61,963	15,294,646	—
Securities lending collateral.....	10,305,034	81,093	6,052	60,804	13,512	3,056,583	—
Receivables:							
Accounts receivable.....	2,687	—	—	—	—	1,413	—
Intergovernmental receivable.....	—	—	—	—	—	—	—
Interest receivable.....	651	9	—	8	5	184	—
Contributions receivable.....	47,079	—	21	—	—	34,758	—
Due from other funds.....	18,328	834	—	—	—	—	—
Notes receivable.....	—	—	—	—	—	—	159,644
Capital assets-depreciable, net.....	—	—	—	—	—	—	—
Total Assets.....	62,162,325	485,081	36,254	363,606	76,917	18,411,761	3,486,630
Liabilities							
Accounts payable and accrued liabilities:							
Accounts payable.....	—	—	—	3	—	—	—
Benefits payable.....	6,037	—	—	—	11	370	—
Medical claims payable.....	—	—	—	—	—	—	—
Obligations under securities lending.....	10,305,034	81,093	6,052	60,804	13,512	3,056,583	—
Due to other funds.....	—	—	—	—	—	—	—
Unearned revenue.....	—	—	—	—	—	—	—
Compensated absences.....	—	—	—	—	—	—	—
Total Liabilities.....	10,311,071	81,093	6,052	60,807	13,523	3,056,953	—
Net Assets							
Held in trust for:							
Employees' pension and other benefits.....	51,851,254	403,988	30,202	302,799	63,394	15,354,808	3,486,630
Total Net Assets.....	\$ 51,851,254	\$ 403,988	\$ 30,202	\$ 302,799	\$ 63,394	\$ 15,354,808	\$ 3,486,630

A schedule of funding progress for each defined benefit plan is presented on page 160.

NOTES TO THE FINANCIAL STATEMENTS

Deferred Compensation Plan	Death Benefit Plan of N.C.	State Health Plan	Retiree Health Benefit Fund	Disability Income Plan of N.C.	Sheriffs' Pension Fund	Register of Deeds' Supplemental Pension Fund	Totals
\$ 2,622	\$ 8,441	\$ 245,995	\$ 136,957	\$ 8,989	\$ 1,378	\$ 475	\$ 487,827
36,157	—	—	—	—	—	—	923,867
619,213	—	—	—	—	—	—	3,058,476
—	233,499	—	—	249,671	—	27,370	68,334,472
—	137,925	191,486	117,477	147,463	1,182	15,723	14,134,334
4,741	46	17,293	—	9,222	—	—	35,402
—	—	13,050	—	—	—	—	13,050
—	28	928	425	35	4	1	2,278
1,658	1,170	—	24,748	3,386	—	313	113,133
—	352	—	8,995	1,208	—	—	29,717
—	—	—	—	—	—	—	159,644
—	—	29	—	—	—	—	29
<u>664,391</u>	<u>381,461</u>	<u>468,781</u>	<u>288,602</u>	<u>419,974</u>	<u>2,564</u>	<u>43,882</u>	<u>87,292,229</u>
180	158	8,644	—	—	—	—	8,985
—	2,747	—	—	319,243	—	—	328,408
—	—	170,465	—	—	—	—	170,465
—	137,925	191,486	117,477	147,463	1,182	15,723	14,134,334
—	—	28	—	—	—	—	28
—	—	6,312	—	—	—	—	6,312
—	—	119	—	—	—	—	119
<u>180</u>	<u>140,830</u>	<u>377,054</u>	<u>117,477</u>	<u>466,706</u>	<u>1,182</u>	<u>15,723</u>	<u>14,648,651</u>
664,211	240,631	91,727	171,125	(46,732)	1,382	28,159	72,643,578
<u>\$ 664,211</u>	<u>\$ 240,631</u>	<u>\$ 91,727</u>	<u>\$ 171,125</u>	<u>\$ (46,732)</u>	<u>\$ 1,382</u>	<u>\$ 28,159</u>	<u>\$72,643,578</u>

NOTES TO THE FINANCIAL STATEMENTS

COMBINING STATEMENT OF CHANGES IN PLAN NET ASSETS

For the Fiscal Year Ended June 30, 2006

(Dollars in Thousands)

	Teachers' and State Employees' Retirement System	Consolidated Judicial Retirement System	Legislative Retirement System	Firemen's and Rescue Squad Workers' Pension Fund	North Carolina National Guard Pension Fund	Local Governmental Employees' Retirement System	401(k) Supplemental Retirement Income Plan
Additions:							
Contributions:							
Employer.....	\$ 315,225	\$ 6,989	\$ —	\$ —	\$ —	\$ 229,399	\$ 125,876
Members.....	720,014	3,661	256	2,670	—	280,700	221,539
Other contributions.....	—	—	—	7,926	6,042	—	—
Total contributions.....	1,035,239	10,650	256	10,596	6,042	510,099	347,415
Investment Income:							
Investment earnings (loss).....	4,085,328	31,745	2,407	23,795	4,792	1,191,974	226,795
Less investment expenses.....	(512,843)	(4,020)	(304)	(3,030)	(638)	(150,114)	—
Net investment income (loss).....	3,572,485	27,725	2,103	20,765	4,154	1,041,860	226,795
Other additions:							
Fees, licenses and fines.....	—	—	—	—	—	4,793	—
Interest earnings on loans.....	—	—	—	—	—	—	7,912
Miscellaneous.....	1,881	—	—	(2)	—	19	—
Total other additions.....	1,881	—	—	(2)	—	4,812	7,912
Total additions.....	4,609,605	38,375	2,359	31,359	10,196	1,556,771	582,122
Deductions:							
Claims and benefits.....	2,536,588	22,253	1,693	18,972	3,806	584,336	166,661
Medical insurance premiums for retirees.....	—	—	—	—	—	—	—
Refund of contributions.....	82,072	32	25	618	—	59,516	—
Administrative expenses.....	7,300	32	6	590	42	2,758	1,054
Other deductions.....	1	—	—	—	—	—	—
Total deductions.....	2,625,961	22,317	1,724	20,180	3,848	646,610	167,715
Change in net assets.....	1,983,644	16,058	635	11,179	6,348	910,161	414,407
Net assets — July 1.....	49,867,610	387,930	29,567	291,620	57,046	14,444,647	3,072,223
Net assets — June 30.....	\$ 51,851,254	\$ 403,988	\$ 30,202	\$ 302,799	\$ 63,394	\$ 15,354,808	\$ 3,486,630

NOTES TO THE FINANCIAL STATEMENTS

Deferred Compensation Plan	Death Benefit Plan of N.C.	State Health Plan	Retiree Health Benefit Fund	Disability Income Plan of N.C.	Sheriffs' Pension Fund	Registers of Deeds' Supplemental Pension Fund	Totals
\$ —	\$ 21,455	\$ 1,588,639	\$ 476,761	\$ 65,009	\$ 1,237	\$ 3,219	\$ 2,833,809
45,039	—	310,298	—	—	—	—	1,584,177
—	9,704	23,727	—	—	—	—	47,399
45,039	31,159	1,922,664	476,761	65,009	1,237	3,219	4,465,385
40,096	(601)	20,069	6,771	(422)	79	(88)	5,632,740
—	(5,379)	(10,086)	(3,403)	(5,838)	(40)	(597)	(696,292)
40,096	(5,980)	9,983	3,368	(6,260)	39	(685)	4,936,448
—	—	—	—	—	—	—	4,793
—	—	—	—	—	—	—	7,912
—	—	—	—	—	—	—	1,898
—	—	—	—	—	—	—	14,603
85,135	25,179	1,932,647	480,129	58,749	1,276	2,534	9,416,436
41,023	26,412	1,698,407	—	87,884	785	844	5,189,664
—	—	—	411,760	—	—	—	411,760
—	—	—	—	—	—	—	142,263
1,989	568	81,951	—	457	—	18	96,765
—	—	85	—	—	87	—	173
43,012	26,980	1,780,443	411,760	88,341	872	862	5,840,625
42,123	(1,801)	152,204	68,369	(29,592)	404	1,672	3,575,811
622,088	242,432	(60,477)	102,756	(17,140)	978	26,487	69,067,767
\$ 664,211	\$ 240,631	\$ 91,727	\$ 171,125	\$ (46,732)	\$ 1,382	\$ 28,159	\$ 72,643,578

NOTES TO THE FINANCIAL STATEMENTS

NOTE 16: SEGMENT INFORMATION

Primary Government. The Town of Butner water and sewer system is administered by the North Carolina Department of Health and Human Services. The State issued revenue bonds to finance upgrades to the Town's water treatment plant, wastewater plant, sanitary sewer system, and water distribution system. This system provides water and sewer services to the State facilities in the Town of Butner as well as to other customers in southern Granville County.

Component Unit. The North Carolina Housing Finance Agency's Home Ownership Bond Programs and Rental Bond Programs are initially funded with revenue bond proceeds. These proceeds are used to purchase single family home and rental property mortgage loans which provide the income along with investment earnings to repay the debt.

Condensed financial statements for the Town of Butner water and sewer system and the two segments of the North Carolina Housing Finance Agency as of and for the fiscal year ended June 30, 2006 are presented below (dollars in thousands).

	Town of Butner Water and Sewer	N.C. Housing Finance Agency Home Ownership	Rental
Condensed Statement of Net Assets			
Assets:			
Current assets.....	\$ 8,876	\$ 46,616	\$ 14,398
Capital assets-nondepreciable.....	1,795	—	—
Capital assets-depreciable, net.....	24,275	—	—
Other assets.....	1,734	1,588,418	129,889
Total assets.....	<u>36,680</u>	<u>1,635,034</u>	<u>144,287</u>
Liabilities:			
Current liabilities.....	4,614	189,617	5,866
Noncurrent liabilities.....	9,893	1,276,735	91,152
Total liabilities.....	<u>14,507</u>	<u>1,466,352</u>	<u>97,018</u>
Net assets:			
Invested in capital assets, net of related debt.....	17,237	—	—
Restricted.....	—	168,682	47,269
Unrestricted.....	4,936	—	—
Total net assets.....	<u>\$ 22,173</u>	<u>\$ 168,682</u>	<u>\$ 47,269</u>
Condensed Statement of Revenues, Expenses, and Changes in Net Assets			
Operating revenues (pledged against bonds).....	2,400	\$ 80,988	\$ 7,317
Depreciation expense.....	(1,662)	—	—
Other operating expenses.....	(2,261)	(70,026)	(6,416)
Operating income.....	<u>(1,523)</u>	<u>10,962</u>	<u>901</u>
Nonoperating revenues (expenses):			
Investment earnings.....	312	—	—
Interest expense.....	(433)	—	—
Other nonoperating revenues (expenses).....	(132)	—	—
Transfers out.....	(238)	(978)	(1,964)
Change in net assets.....	<u>(2,014)</u>	<u>9,984</u>	<u>(1,063)</u>
Net assets — July 1, as restated.....	24,187	158,698	48,332
Net assets — June 30.....	<u>\$ 22,173</u>	<u>\$ 168,682</u>	<u>\$ 47,269</u>
Condensed Statement of Cash Flows			
Net cash provided (used) by:			
Operating activities.....	\$ 275	\$ (6,557)	\$ 30,206
Noncapital financing activities.....	(238)	225,526	(43,253)
Capital and related financing activities.....	(1,130)	—	—
Investing activities.....	158	(287,754)	(9,930)
Net increase (decrease).....	<u>(935)</u>	<u>(68,785)</u>	<u>(22,977)</u>
Cash and cash equivalents at July 1.....	7,338	124,781	34,179
Cash and cash equivalents at June 30.....	<u>\$ 6,403</u>	<u>\$ 55,996</u>	<u>\$ 11,202</u>

NOTES TO THE FINANCIAL STATEMENTS

NOTE 17: COMPONENT UNITS — FINANCIAL INFORMATION

The financial statements for the University of North Carolina System and Community Colleges include their nongovernmental component unit foundations and similarly affiliated organizations. Financial statements for component units as of and for the fiscal year ended June 30, 2006 are presented below (dollars in thousands).

Statement of Net Assets							
	The Golden LEAF, Inc.	University of North Carolina System	Community Colleges	N.C. Housing Finance Agency	State Education Assistance Authority	Other Component Units	Total
Assets							
Cash and cash equivalents.....	\$ 568	\$ 2,049,928	\$ 161,427	\$ 124,305	\$ 204,101	\$ 61,427	\$ 2,601,756
Investments.....	596,640	1,767,689	44,332	551,565	570,356	17,438	3,548,020
Receivables, net.....	2	673,589	63,958	26,579	151,645	12,056	927,829
Due from component units.....	—	52,303	4,629	—	1,510	375	58,817
Due from primary government.....	—	38,861	33,195	46,944	24,726	—	143,726
Inventories.....	—	60,468	15,206	—	23	859	76,556
Prepaid items.....	30	13,332	1,009	—	814	492	15,677
Notes receivable, net.....	424	132,536	811	1,226,004	2,415,468	11,877	3,787,120
Endowment investments.....	—	1,986,971	110,011	—	—	—	2,096,982
Investment in joint venture.....	—	8,319	—	—	—	—	8,319
Deferred charges.....	—	10,840	15	—	12,187	683	23,725
Capital assets-nondepreciable.....	—	1,439,313	306,116	447	—	125,654	1,871,530
Capital assets-depreciable, net.....	21	5,480,076	1,196,408	1,854	4,974	190,476	6,873,809
Total Assets.....	597,685	13,714,225	1,937,117	1,977,698	3,385,804	421,337	22,033,866
Liabilities							
Accounts payable and accrued liabilities.....	26,551	517,334	42,604	13,607	858	7,352	608,306
Medical claims payable.....	—	4,917	—	—	—	—	4,917
Interest payable.....	—	15,471	7	12,404	23,347	228	51,457
Short-term debt.....	—	139,582	—	—	—	—	139,582
Due to component units.....	58,817	—	—	—	—	—	58,817
Due to primary government.....	1,662	1,053	27	—	—	10,016	12,758
Unearned revenue.....	—	121,110	8,018	896	—	2,352	132,376
Advance from primary government.....	—	—	—	—	—	25,364	25,364
Obligations under reverse repurchase agreements.....	—	—	—	4,615	—	—	4,615
Deposits payable.....	—	8,464	—	3,168	—	68	11,700
Funds held for others.....	—	438,615	1,807	—	238,709	124	679,255
Long-term liabilities:							
Due within one year.....	—	275,722	9,174	178,224	506,383	3,107	972,610
Due in more than one year.....	—	2,590,242	71,129	1,368,514	2,056,680	54,364	6,140,929
Total Liabilities.....	87,030	4,112,510	132,766	1,581,428	2,825,977	102,975	8,842,686
Net Assets							
Invested in capital assets, net of related debt.....	21	4,596,695	1,488,475	2,301	4,974	240,309	6,332,775
Restricted for:							
Nonexpendable:							
Higher education.....	—	1,318,397	101,871	—	—	—	1,420,268
Expendable:							
Higher education.....	—	1,783,212	147,365	—	545,382	—	2,475,959
Health and human services.....	—	—	—	—	—	5,798	5,798
Economic development.....	—	—	—	381,801	—	—	381,801
Other purposes.....	—	—	—	—	—	32	32
Unrestricted.....	510,634	1,903,411	66,640	12,168	9,471	72,223	2,574,547
Total Net Assets.....	\$ 510,655	\$ 9,601,715	\$ 1,804,351	\$ 396,270	\$ 559,827	\$ 318,362	\$ 13,191,180

NOTES TO THE FINANCIAL STATEMENTS

Statement of Activities

	The Golden LEAF, Inc.	University of North Carolina System	Community Colleges	N.C. Housing Finance Agency	State Education Assistance Authority	Other Component Units	Total
Total expenses.....	\$ 28,773	\$ 6,650,114	\$ 1,502,874	\$ 251,870	\$ 249,312	\$ 195,104	\$ 8,878,047
Program revenues:							
Charges for services.....	5	3,903,663	242,184	244,466	154,206	56,702	4,601,206
Operating grants and contributions.....	48,444	929,272	452,649	32,068	38,717	20,344	1,521,494
Capital grants and contributions.....	—	32,747	60,971	—	—	715	94,433
Net program (expense) revenue.....	19,676	(1,784,432)	(747,090)	24,664	(56,389)	(117,343)	(2,660,914)
Non-tax general revenues:							
State operating aid.....	68,227	2,131,110	728,340	10,451	69,745	124,132	3,132,005
State capital aid.....	—	398,737	68,000	—	—	23,242	489,979
Miscellaneous.....	—	5,430	112	—	—	5,084	10,626
Total non-tax general revenues.....	68,227	2,535,277	796,452	10,451	69,745	152,458	3,632,610
Contributions to endowments.....	—	103,206	6,541	—	—	—	109,747
Change in net assets.....	87,903	854,051	55,903	35,115	13,356	35,115	1,081,443
Net assets — July 1, as restated (Note 22).....	422,752	8,747,664	1,748,448	361,155	546,471	283,247	12,109,737
Net assets — June 30.....	\$ 510,655	\$ 9,601,715	\$ 1,804,351	\$ 396,270	\$ 559,827	\$ 318,362	\$ 13,191,180

Significant Balances and Transactions Between Component Units

	The Golden LEAF, Inc.	University of North Carolina System	Community Colleges	N.C. Housing Finance Agency	State Education Assistance Authority	Other Component Units	Total
The Golden LEAF, Inc.:							
Due from (due to) component units.....	\$ (58,817)	\$ 52,303	\$ 4,629	\$ —	\$ 1,510	\$ 375	\$ —
Grant revenue (expense).....	(8,712)	4,430	2,725	—	1,500	57	—
UNC System operating aid.....	—	(9,176)	—	—	9,176	—	—

Advances To Component Units/Advances From Primary Government

The balance of \$21.742 million advanced to the N.C. Global TransPark Authority from the Escheats Fund (a special revenue fund) resulted from a \$25 million advance for the purposes of the acquisition of real property in prior fiscal years. The advance is due on October 1, 2007, and will be repaid with interest at a variable rate based upon the earnings record of the State Treasurer's Long-Term Investment Fund. The balance of \$3.622 million advanced to the North Carolina Turnpike Authority from the Highway Trust Fund is related to startup operating costs.

Intra-Entity Balances — Between Primary Government and Component Units

	Due From Component Units				Due From Primary Government				
	General Fund	Other Governmental Funds	Other Funds	Total	University of North Carolina System	Community Colleges	NC Housing Finance Agency	State Education Assistance Authority	Total
Due To Component Units:									
General Fund.....	\$ —	\$ —	\$ —	\$ —	\$ 1,502	\$ —	\$ 46,944	\$ —	\$ 48,446
Other Governmental Funds.....	—	—	—	—	37,359	33,195	—	24,726	95,280
Due To Primary Government:									
The Golden LEAF, Inc.....	1,153	509	—	1,662	—	—	—	—	—
University of North Carolina System.....	—	3	1,050	1,053	—	—	—	—	—
Community Colleges.....	—	—	27	27	—	—	—	—	—
Other Component Units.....	1,285	8,728	3	10,016	—	—	—	—	—
Total.....	\$ 2,438	\$ 9,240	\$ 1,080	\$ 12,758	\$ 38,861	\$ 33,195	\$ 46,944	\$ 24,726	\$ 143,726

NOTES TO THE FINANCIAL STATEMENTS

NOTE 18: RELATED ORGANIZATIONS

MCNC

MCNC (formerly the Microelectronics Center of North Carolina) is a legally separate non-profit corporation fostering the advancement of education, innovation and economic development throughout North Carolina by providing high quality network infrastructure and network-based services. It is managed by a Board of Directors ranging from thirteen to twenty members. Six of the members are appointed by the Governor. Another seven members serve ex officio as follows: four are chancellors of universities in the UNC System, a component unit of the State; one is the president of MCNC; one is designated by the Board of Trustees of Duke University; and one is designated by the Board of Governors of the Research Triangle Institute. These Governor-appointed members and ex officio members may elect up to seven other board members. Any appointed director may be removed from office by the Governor for cause. Any elected director may be removed by the Board of Directors at will.

Centennial Authority

The Centennial Authority is a legally separate organization established to study, design, plan, construct, own, promote, finance, and operate a regional facility in Wake County, North Carolina, now known as the RBC Center. The RBC Center houses entertainment shows and is home to two sports teams, the National Hockey League's Carolina Hurricanes and North Carolina State University men's basketball. The Authority is governed by a twenty-one member board comprised of ten members appointed by the General Assembly, four members appointed by the Wake County Board of Commissioners, four members appointed by the Raleigh City Council, two members appointed jointly by the mayors of all the cities in Wake County, and the chancellor of North Carolina State University (or the Chancellor's designee). A member may be removed by the appointing authority for cause.

North Carolina Capital Facilities Finance Agency

The North Carolina Capital Facilities Finance Agency provides the benefits of tax-exempt financing to non-profit institutions providing elementary and secondary education, private institutions of higher education, and various other entities for special purpose projects serving a public interest (see Note 20). The agency is governed by a seven member board comprised of two members appointed by the General Assembly, three members appointed by the Governor, and the State Treasurer and the State Auditor, both of whom serve ex officio.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 19: RELATED PARTY TRANSACTIONS

Primary Government**Supplemental Retirement Income Plan of North Carolina**

Included in Plan assets is a stable value fund sponsored by the contractor, Prudential Retirement Services. Investment earnings in the Prudential Stable Value Fund amounted to approximately \$33.5 million in 2005. The asset values of this fund are disclosed in Note 3.

North Carolina Public Employee Deferred Compensation Plan

Under the terms of an agreement effective January 1, 2004, the Plan's Board of Trustees appointed Great-West Life & Annuity Insurance Company (Great-West), as the Plan's third-party administrator. The Plan recognized \$1.95 million in expenses related to Great-West for the year ended December 31, 2005. The portion of annuity payout contract assets attributable to contracts with Great-West at December 31, 2005 was \$27.41 million.

Component Units**University of North Carolina System and Community College Foundations**

The University of North Carolina (UNC) System and community colleges have separately incorporated not-for-profit foundations that are associated with constituent institutions of the UNC System or individual colleges. These organizations serve as a fundraising arm of the respective institutions through which individuals, corporations, and other organizations support institution programs by providing scholarships, fellowships, faculty salary supplements, and unrestricted funds to specific departments and the institution's overall academic environment. These affiliated organizations are not included as component units since the economic resources received or held by an individual organization are not significant to the primary government. Therefore, the financial statements of the UNC System and community colleges do not include the assets, liabilities, net assets, or operational transactions of these foundations, except for support from each organization to constituent institutions or colleges. For the fiscal year ended June 30, 2006, this support approximated \$47.23 million for the UNC System and \$661 thousand for community colleges.

Related Organization**Centennial Authority**

The Centennial Authority (Authority), a related organization of the State of North Carolina, was created by the 1995 General Assembly for the purpose of studying,

designing, planning, constructing, owning, promoting, financing and operating a regional facility on land owned by the State. Prior to this act, the General Assembly authorized the construction by North Carolina State University (the University) of a facility to be known as the "Entertainment and Sports Arena" (ESA). This facility serves as a regional sports entertainment center and is available for cultural performances, sporting events and other activities of the University or of other entities (the Centennial Center project). With the 1995 legislation, the Centennial Center project was transferred to the Authority.

The Authority entered into a ground lease with the State of North Carolina to lease land for the ESA for a period of 99 years at an annual rent of \$1. The University entered into a use agreement with the Authority. Both parties agreed that the University shall be the primary and preferred user of all areas of the ESA. The University is required to pay the greater of 10% of gross ticket revenues or \$44 thousand for each men's and \$19 thousand for each women's basketball game to compensate the Authority for facility rental and operating expenses. Rent and expense payments for miscellaneous events are negotiated on an event by event basis based on the availability of the ESA and the anticipated attendance.

In fiscal year 2003 a naming rights agreement was executed to change the name of the ESA to the "RBC Center." As a result of this agreement, the University will receive \$13.18 million over a ten-year period which began in 2003.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 20: COMMITMENTS AND CONTINGENCIES

A. No Commitment Debt

The State, by action of the General Assembly, created the North Carolina Medical Care Commission which is authorized to issue tax-exempt bonds and notes to finance construction and equipment projects for nonprofit and public hospitals, nursing homes, continuing care facilities for the elderly and related facilities. The bonds are not an indebtedness of the State and, accordingly, are not reflected in the accompanying financial statements. Each issue is payable solely from the revenues of the facility financed by that issue and any other credit support provided. Therefore, each issue is separately secured and is separate and independent from all other issues as to source of payment and security. The indebtedness of each entity is serviced and administered by a trustee independent of the State. Maturing serially to calendar year 2041, the outstanding principal of such bonds and notes as of June 30, 2006, was \$5.9 billion with interest rates varying from 1.6% to 7.57%.

The North Carolina Capital Facilities Finance Agency is authorized by the State to issue tax-exempt bonds and notes to finance industrial and manufacturing facilities, pollution control facilities for industry (in connection with manufacturing) where there is a favorable impact on employment or pollution control commensurate with the size and cost of the facilities and to finance facilities and structures at private nonprofit colleges and universities, and institutions providing kindergarten, elementary and secondary education. Its authority to issue bonds and notes also includes financing private sector capital improvements for activities that constitute a public purpose. The bonds are not an indebtedness of the State and, accordingly, are not reflected in the accompanying financial statements. Each issue is payable solely from the revenues of the facility financed by that issue and any other credit support provided. Therefore, each issue is separately secured and is separate and independent from all other issues as to source of payment and security. The indebtedness of each issue is serviced and administered by a trustee independent of the State. Maturing serially to calendar year 2045, the outstanding principal of such bonds and notes as of June 30, 2006, was \$1.7 billion with fixed interest rates varying from 2.4% to 7.1% and variable interest rates which can be reset weekly.

B. Litigation

Hoke County et al. v. State of North Carolina and State Board of Education — Right to a Sound Basic Education (formerly Leandro). In 1994, students and boards of education in five counties in the State filed suit in Superior Court requesting a declaration that the public education system of North Carolina, including its system of funding, violates the state Constitution by failing to provide adequate or substantially equal educational opportunities, by denying due process of law, and by violating various statutes relating to public education. Five other school boards and students therein intervened, alleging claims for

relief on the basis of the high proportion of at-risk and high-cost students in their counties' systems.

The suit is similar to a number of suits in other states, some of which resulted in holdings that the respective systems of public education funding were unconstitutional under the applicable state law. The State filed a motion to dismiss, which was denied. On appeal, the North Carolina Supreme Court upheld the present funding system against the claim that it unlawfully discriminated against low wealth counties, but remanded the case for trial on the claim for relief based on the Court's conclusion that the constitution guarantees every child the opportunity to obtain a sound basic education. Trial on the claim of one plaintiff-county was held in the fall of 1999. On October 26, 2000 the trial court, in Section Two of a projected three-part ruling, concluded that at-risk children in North Carolina are constitutionally entitled to such pre-kindergarten educational programs as may be necessary to prepare them for higher levels of education and the "sound basic education" mandated by the Supreme Court. On March 26, 2001, the Court issued Section Three of the three-part ruling, in which the judge ordered all parties to investigate certain school systems to determine why they are succeeding without additional funding. The State filed a Notice of Appeal to the Court of Appeals, which resulted in the Court's decision to re-open the trial and call additional witnesses. That proceeding took place in the fall of 2001. On April 4, 2002, the Court entered Section Four of the ruling, ordering the State to take such actions as may be necessary to remedy the constitutional deficiency for those children who are not being provided with access to a sound basic education and to report to the Court at 90-day intervals remedial actions being implemented. On July 30, 2004, the North Carolina Supreme Court affirmed the majority of the trial court's orders, thereby directing the executive and legislative branches to take corrective action necessary to ensure that every child has the opportunity to obtain a sound, basic education. The Supreme Court did agree with the State that the trial court exceeded its authority in ordering pre-kindergarten programs for at-risk children. The State is now undertaking measures to respond to the trial court's directives. The magnitude of state resources which may ultimately be required cannot be determined at this time; however, the total cost could exceed \$100 million.

N.C. School Boards Association, et al. v. Richard H. Moore, State Treasurer, et al. — Use of Administration Payments. On December 14, 1998, plaintiffs, including county school boards of Wake, Durham, Johnston, Buncombe, Edgecombe and Lenoir Counties, filed suit in Superior Court requesting a declaration that certain payments to state administrative agencies must be distributed to the public schools on the theory that such amounts are civil penalties which under the North Carolina Constitution must be paid to the schools.

NOTES TO THE FINANCIAL STATEMENTS

On December 14, 2001, the Superior Court of Wake County granted summary judgment in favor of the plaintiffs on all issues, concluding that the funds in dispute are civil fines or penalties required by Article IX, Section 7 of the Constitution to be remitted to the public schools in the county where the violation occurred. The court further determined a three-year statute of limitations to be applicable, making the order retroactive to December 1995. This case was argued in the Court of Appeals in February, 2003. The North Carolina Court of Appeals rendered a decision in September 2003 substantially favorable to the State. On July 1, 2005, the Supreme Court reversed the Court of Appeals in part, concluding that a majority of the funds in dispute are civil penalties required to be paid into the Civil Penalty and Forfeiture Fund for the benefit of public schools. Based upon information supplied by the defendant state agencies, the amount owed could be as much as \$770 million. The case is now pending in Superior Court while the parties discuss a negotiated resolution.

Southeast Compact Commission — Disposal of Low-level Radioactive Waste. North Carolina and seven other southeastern states created the Southeast Interstate Low-level Radioactive Waste Management Compact to plan and develop a site for the disposal of low-level radioactive waste generated in the member states. North Carolina was assigned responsibility for development of the first disposal site, with costs to be distributed equitably among the Compact members. In 1997, the Compact Commission discontinued funding of the development of the North Carolina site, alleging that the State was not actively pursuing the permitting and development of the proposed site. North Carolina withdrew from the Compact in 1999. The Compact subsequently asked the United States Supreme Court to accept its Complaint against North Carolina demanding the repayment, with interest, of \$80 million of Compact payments expended on the permitting of the site, plus \$10 million of future lost income, interest and attorney fees. The Supreme Court denied this motion in August 2001. On August 5, 2002 the Compact, with the addition of four member states as plaintiffs, filed a new motion requesting the United States Supreme Court to accept the claim under its original jurisdiction. On June 16, 2003, the Court accepted jurisdiction of the case and the State filed an answer and motion to dismiss on August 21, 2003. On November 17, 2003, the motion to dismiss was denied, and the U.S. Supreme Court appointed a Special Master with authority to determine when additional pleadings will be filed in the case. The Special Master heard oral arguments on dispositive motions filed by both sides on September 3, 2004 and in September, 2006 allowed the State's motions as to several claims. The parties will continue to litigate the remaining claims.

Philip Morris USA Inc. v. Tolson — Refund of Corporate Income Tax. On June 13, 2000, Philip Morris filed a complaint in Wake County Superior Court for a refund of approximately \$30 million in corporate income taxes paid for 1989 through 1991. An order of the Augmented Tax

Review Board in the 1970's allowed it to apportion its income under a modified formula, which included a more favorable property factor. When the law changed in 1989 to move to double weighting of the sales factor, Philip Morris incorporated this change into its formula. The Board's order did not permit double weighting. Philip Morris argued that the principle of *in pari materia* required incorporation of the amendment, and that failure to allow double weighting violated the equal protection and separation of powers clauses. The Wake County Superior Court ruled that Philip Morris was required to use the formula approved by the Board without double weighting the sales factor unless the statutory formula (without the modified property factor) produced a more favorable result. Philip Morris appealed this ruling to the North Carolina Court of Appeals. The Court of Appeals issued a unanimous opinion affirming the superior court. Philip Morris has filed a notice of appeal and petition for discretionary review with the North Carolina Supreme Court.

State Employees Association of North Carolina v. State; Stone v. State — Diversion of Employer's Retirement System Contribution. On May 22, 2001, SEANC filed an action in Wake County Superior Court demanding repayment of approximately \$129 million in employer retirement contributions to the Retirement Systems. The Governor withheld, and subsequently used, the withheld funds under his constitutional authority to balance the state budget. The trial court dismissed the action on May 23, 2001, and the North Carolina Court of Appeals affirmed this dismissal on December 3, 2002. The Supreme Court, on June 13, 2003, reversed the Court of Appeals on issues related to class standing and remanded with instructions to consider procedural issues raised but not addressed by the Court of Appeals. The Court of Appeals remanded the case to the Superior Court of Wake County without opinion and without considering any remaining issues.

In June 2002, the *Stone* case was filed in Wake County Superior Court on behalf of individual State employees and retirees seeking repayment of the withheld employer contribution and a prohibition against future diversions. A class comprised of all members of the Retirement System has been certified and the case is currently proceeding through class notification and toward trial. On September 6, 2006, the trial court issued an interlocutory order in response to cross-motions for summary judgment. The court's order found the diversion of funds to be in violation of the constitution, but did not direct any repayment of funds.

Goldston v. State of North Carolina — Highway Trust Fund Transfers. On November 14, 2002, a lawsuit was filed in Wake County Superior Court demanding that \$80 million transferred by the Governor from the Highway Trust Fund to the General Fund for purposes of balancing the state budget be returned to the Highway Trust Fund. The suit further

NOTES TO THE FINANCIAL STATEMENTS

alleges that actions of the General Assembly regarding the transfer of funds from the Highway Trust Fund to the General Fund constitute a borrowing by the State of Highway Trust Fund cash surplus and are unlawful and unconstitutional. The lawsuit requests a declaration that taxes collected for purposes of Highway Trust Fund expenditures cannot be used for other purposes. Summary Judgment was granted in favor of the State on all issues and Plaintiff has filed a notice of appeal. On September 20, 2005, the North Carolina Court of Appeals upheld the trial court's order. The plaintiff filed a petition for discretionary review with the North Carolina Supreme Court, and the Court agreed on March 2, 2006 to review a portion of the Court of Appeals' decision and oral argument is scheduled for October 16, 2006.

Diana Coley, et al. v. State of North Carolina, et al. — Refund of Income Tax. On April 25, 2003, Plaintiffs filed suit in the Superior Court of Wake County against the State of North Carolina and the Secretary of Revenue challenging the constitutionality of retroactively applying the 2001 increase in the highest rate of North Carolina's state income tax to the entire 2001 tax year. Plaintiffs seek refunds, for themselves and a proposed class of similarly situated taxpayers, of all taxes paid for the year 2001 in excess of the prior 7.75% maximum rate, on the theory that a retroactive midyear tax increase violates the state and federal constitutions. Plaintiffs claim the total amount of taxes involved exceeds \$76 million, plus interest. On June 30, 2004, the trial court granted summary judgment in favor of the State on all issues. Plaintiffs appealed to the Court of Appeals. The Court of Appeals issued a 2-1 opinion sustaining the constitutionality of the tax. Plaintiffs appealed to the North Carolina Supreme Court. Arguments were heard in the Supreme Court in March 2006. The Supreme Court upheld the Court of Appeals decision on June 30, 2006. A petition for rehearing was denied on August 17, 2006.

DirecTV, Inc. and EchoStar Satellite Corporation v. State of North Carolina et al. — Refund of Sales Tax. Effective January 1, 2002, the legislature enacted a provision to impose the sales tax on satellite TV service providers. On September 30, 2003, DirecTV and Echostar filed a complaint in Wake County Superior court for a refund of state sales tax paid, which currently amounts to approximately \$70 million. Plaintiffs claim this tax, which was not imposed on cable television providers, is unconstitutional under the Commerce Clause because it discriminates against interstate commerce. It is the State's position that the sales tax does not violate the Commerce Clause. Although cable providers are not subject to this tax, they are subject to city and county franchise taxes. The tax on satellite companies was enacted to equalize the tax burden on these various forms of entertainment. In 2005, the trial court allowed summary judgment in the State's favor.

Plaintiffs appealed to the North Carolina Court of appeals. Oral arguments were heard on May 9, 2006. On August 1, 2006, the Court of Appeals unanimously affirmed the decision and upheld the constitutionality of the tax.

Lessie J. Dunn, et al. v. The State of North Carolina, et al. — Tax on Municipal Bonds. On February 9, 2004, Plaintiffs, on behalf of a class of all others similarly situated, filed suit in Forsyth County Superior Court alleging that the State's imposition and collection of state income tax on interest received by certain taxpayers on municipal bonds issued by non-North Carolina state and local governments constitutes a violation of the Commerce Clause of the United States Constitution and seeking class certification. An order certifying a class has been entered by the superior court. The State has appealed the scope of the class certification to the North Carolina Court of Appeals. On October 17, 2006, the Court of Appeals unanimously affirmed the order certifying the class.

Wal-Mart Stores East, Inc. v. Tolson and Sam's East, Inc. v. Tolson — Refund of Corporate Income Tax. On March 17, 2006, the Plaintiffs filed complaints seeking a refund of over \$33.5 million in corporate income taxes in Wake County Superior Court (06 CVS 3928 and 06 CVS 3929). Plaintiffs are challenging the Secretary's authority to require them to file a "combined return" on various statutory and constitutional grounds. Defendant has filed a motion to dismiss under Rule 12(b)(6) and Plaintiffs have filed a motion for summary judgment. On August 31, 2006, Defendant's Motion to Dismiss was heard before Judge Horton who has been assigned to hear the actions as exceptional cases.

State of North Carolina v. Philip Morris, Inc., et al., 98 CVS 14377 — Master Settlement Agreement ("MSA") Payments. On April 20, 2006, the State of North Carolina filed a Motion for Declaratory Order in the North Carolina Business Court against defendants Philip Morris, Inc., R.J. Reynolds Tobacco Company, and Lorillard Tobacco Company. The Motion is seeking a declaration that (1) in 2003, North Carolina continuously had a Qualifying Statute in full force and effect and "diligently enforced" its provisions throughout that year in accordance with the MSA; (2) North Carolina is not subject to a Non-Participating Manufacturers' Adjustment for 2003; and (3) defendants are obligated not to withhold or pay into a disputed payments account any payments due, or seek any offset of any payments made, on the basis that North Carolina is subject to a Non-Participating Manufacturers' Adjustment for 2003. If the State is unable to ultimately prevail in the diligent enforcement litigation, the State may be unable to recover a portion of this year's MSA payment.

Petroleum Traders Corporation (PTC) v. State. Petroleum Traders Corporation (PTC) brought a Declaratory Judgment

NOTES TO THE FINANCIAL STATEMENTS

action in Wake County Superior Court on July 19, 2006, seeking a declaration that the North Carolina e-procurement fee is a tax and is unconstitutional under provisions of the state and national constitutions. PTC claims to have paid over \$1 million itself in e-procurement fees. PTC also seeks to have the action proceed as a class action, allegedly involving potential refunds in excess of \$100 million. The State has moved to dismiss the complaint, and the motion is expected to be heard this year.

Other Litigation. The State is involved in numerous other claims and legal proceedings, many of which are normal for governmental operations. A review of the status of outstanding lawsuits involving the State by the North Carolina Attorney General did not disclose other proceedings that are expected to have a material adverse effect on the financial position of the State.

C. Federal Grants

The State receives significant financial assistance from the Federal Government in the form of grants and entitlements, which are generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal regulations, including the expenditure of the resources for eligible purposes. Under the terms of the grants, periodic audits are required and certain costs may be questioned as not being appropriate expenditures. During the fiscal year ending June 30, 2006, the U.S. Department of Health and Human Services (USDHHS) notified the state Department of Health and Human Services (DHHS) of a disallowance of \$95 million in federal funds under Title IV-E of the Social Security Act. This disallowance has been appealed by DHHS to the USDHHS Departmental Appeals Board.

Any disallowance as a result of questioned costs could become a liability of the State. As of June 30, 2006, the State is unable to estimate what liabilities may result from such audits except for the \$154 million settlement balance with the U.S. Department of Justice and the U.S. Department of Health and Human Services which is included in the long-term liabilities footnote (Note 7).

D. Highway Construction

The State may be liable for approximately \$51.55 million to contractors for highway construction claims that the State has contested. The State may also be liable for an additional \$10.31 million in contested rights-of-way acquisition costs to property owners in condemnation proceedings. These costs have not been included in project-to-date costs. Also, the State is contingently liable for outstanding contractors' claims in the amount of \$114.37 million.

E. USDA-Donated Commodities

The State has custodial responsibility for \$2.81 million of U.S. Department of Agriculture donated food commodities for which the State is liable in the event of loss.

F. Construction and Other Commitments

At June 30, 2006, the State had commitments of \$1.43 billion for construction of highway facilities. Of this amount, \$776.74 million relates to the Highway Fund, and \$651.29 million relates to the Highway Trust Fund. The other commitments for construction and improvements of state government facilities totaled \$580.24 million (including \$442.92 million for the Department of Environment and Natural Resources and \$86.72 million for the Department of Correction).

At June 30, 2006, the University of North Carolina System (component unit) had outstanding construction commitments of \$506.96 million (including \$107.66 million for North Carolina State University, \$84.97 million for North Carolina Agricultural and Technical State University, \$56.82 million for East Carolina University, \$36.23 million for University of North Carolina - Wilmington, \$36.29 million for Appalachian State University and \$35.55 million for University of North Carolina - Charlotte).

At June 30, 2006, community colleges (component units) had outstanding construction commitments of \$153.49 million (including \$39.56 million for Wake Technical Community College, \$15.09 million for Blue Ridge Community College, \$14.75 million for Sandhills Community College, \$11.76 million for College of the Albemarle, \$9.04 million for Cape Fear Community College, and \$8.17 million for Central Piedmont Community College).

At June 30, 2006, The Golden LEAF, Inc. (component unit) had outstanding commitments of \$61.9 million.

G. Tobacco Settlement

In 1998, North Carolina, along with forty-five other states, signed the Master Settlement Agreement (MSA) with the nation's largest tobacco companies to settle existing and potential claims of the states for damages arising from the use of the companies' tobacco products. Under the MSA, the tobacco companies are required to adhere to a variety of marketing, advertising, lobbying, and youth access restrictions, support smoking cessation and prevention programs, and provide payments to the states in perpetuity. The amount that North Carolina will actually receive from this settlement remains uncertain, but projections are that the State will receive approximately \$4.6 billion through the year 2025. In the early

NOTES TO THE FINANCIAL STATEMENTS

years of MSA, participating states received initial payments that were distinct from annual payments. The initial payments were made for five years: 1998 and 2000 through 2003. The annual payments began in 2000 and will continue indefinitely. However, these payments are subject to a number of adjustments including an inflation adjustment and a volume adjustment. Some adjustments (e.g., inflation) should result in an increase in the payments while others (e.g., domestic cigarette sales volume) may decrease the payments. Also, future payments may be impacted by continuing and potential litigation against the tobacco industry and changes in the financial condition of the tobacco companies. At year-end, the State recognizes a receivable and revenue for the tobacco settlement based on the underlying domestic shipment of cigarettes. This accrual estimate is based on the projected payment schedule in the MSA adjusted for historical payment trends.

paid back. As of June 30, 2006, the Authority has received approximately \$20.1 million from the FAA.

In 1999, the State approved legislation to implement the terms of the MSA in North Carolina. The State created a nonprofit corporation, The Golden LEAF, Inc., to distribute 50 percent of the settlement funds received by the State of North Carolina. The legislation directed that these funds be used for the purposes of providing economic impact assistance to economically affected or tobacco-dependent regions of North Carolina. However, the Foundation's share of the payments may be diverted by the North Carolina General Assembly prior to the funds being received by the North Carolina State Specific Account. The Golden LEAF, Inc. is reported as a discretely presented component unit.

In 2000, the State enacted legislation that established the Health and Wellness Trust Fund and the Tobacco Trust Fund and created commissions charged with managing these funds. Each fund will receive 25 percent of the tobacco settlement payments. The purpose of the Health and Wellness Trust Fund is to finance programs and initiatives to improve the health and wellness of the people of North Carolina. An eighteen-member Health and Wellness Trust Fund Commission will administer the Fund. The primary purpose of the Tobacco Trust Fund is to compensate the tobacco-related segment of North Carolina's economy for the economic hardship it is expected to experience as a result of the MSA. An eighteen-member Tobacco Trust Fund Commission will administer the Fund. The Health and Wellness Trust Fund and Tobacco Trust Fund are reported as special revenue funds.

H. Other Contingencies

As of June 30, 2006, the North Carolina Global TransPark Authority (component unit) had a loan outstanding including accrued interest payable totaling \$30.47 million to the Escheat Fund (special revenue fund). The loan is due on October 1, 2007. The current amount of operating cash held by the Authority is not sufficient to pay the balance due to the Escheat Fund and as such, substantial doubt about the Authority's ability to continue as a going concern exists. In addition, if the Authority declares bankruptcy all funding received to date from the Federal Aviation Administration (FAA) is required to be

NOTES TO THE FINANCIAL STATEMENTS

NOTE 21: CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

CHANGE IN METHOD OF APPLYING PREVIOUSLY IMPLEMENTED ACCOUNTING PRINCIPLE

For the fiscal year ended June 30, 2006, the State changed its methodology, as it regards individual income taxes, for applying GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. Specifically, the State now reports an estimate of underpayments of individual income taxes whereas before this change it did not. In addition, the State has changed its method to estimate overpayments of individual income taxes (i.e., income tax refunds payable and applied refunds).

For the purpose of reporting underpayments, the State changed the availability period for recognizing individual income tax revenues in the governmental fund financial statements. The availability period for individual income taxes was extended from thirty-one days to twelve months after year-end (see Note 1). Furthermore, in the circumstance where underpayments exceed overpayments, individual income tax revenues are recognized to the extent of estimated overpayments (i.e., income tax refunds payable and applied refunds).

The change in methodology as described above results in a more accurate estimate of overpayments of individual income taxes and also allows for the accounting recognition of both underpayments and overpayments of individual income taxes in the period when taxable income is earned by taxpayers (see Note 22).

CHANGES RESULTING FROM ADOPTION OF NEW ACCOUNTING PRINCIPLES

For the fiscal year ended June 30, 2006, the State implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

- GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section*.
- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation, an amendment of GASB Statement No. 34*.
- GASB Technical Bulletin No. 2006-1, *Accounting and Financial Reporting by Employers and OPEB Plans for Payments from the Federal Government Pursuant to the Retiree Drug Subsidy Provisions of Medicare Part D*.

GASB Statement No. 44 enhances and updates the statistical section that accompanies the basic financial statements. This pronouncement adds new information that users have identified as important and eliminates certain previous requirements. The statistical section now includes trend information on fund balances and principal employers and government-wide, accrual-based information required by GASB Statement No. 34. It also now includes revenue capacity

information and information about operating indicators and capital assets. Finally, this pronouncement improves the understandability and usefulness of the statistical section by requiring governments to augment their schedules with certain narrative explanations.

GASB Statement No. 46 provides clarifications regarding the meaning of the phrase *legally enforceable* as it applies to restrictions imposed on net asset use by enabling legislation. This pronouncement also specifies the accounting and financial reporting requirements if legal enforceability is reevaluated. During the fiscal year, the State determined that constraints placed on net asset use by enabling legislation are not legally enforceable. An Attorney General Advisory Opinion referenced that the Governor, pursuant to his constitutional authority under Article III, Section 5(3), may use resources restricted by enabling legislation in his discretion to meet a budget shortfall. Such amounts previously reported as restricted are reclassified to unrestricted net assets.

GASB Technical Bulletin No. 2006-1 clarifies how state and local governmental entities should report payments received from the federal government under the retiree drug subsidy provisions of Medicare Part D. Such payments made to the State Health Plan constitute on-behalf payments for fringe benefits. In the statement of changes in plan net assets, the State Health Plan displays payments from the federal government as "Other contributions" (see Note 15).

GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, and GASB Statement 47, *Accounting for Termination Benefits*, have no material impact on the State's financial statements as the items to which these pronouncements would apply are immaterial.

NOTES TO THE FINANCIAL STATEMENTS

NOTE 22: FUND EQUITY RECLASSIFICATIONS AND RESTATEMENTS

The following table reconciles the beginning fund equity as previously reported to the beginning fund equity as restated (dollars in thousands). The adjustments in the *Change in Application of GASB 33* column result from the change in methodology for applying GASB Statement No. 33 to individual income taxes as discussed in Note 21. The amounts in the *Other Adjustments* column are due primarily to the correction of errors related to prior periods.

	July 1, 2005 Fund Equity as Previously Reported	Change in Application of GASB 33	Other Adjustments	July 1, 2005 Fund Equity as Restated
Primary Government				
Major Governmental Funds:				
General Fund	\$ (78,809)	\$ 1,035,504	\$ (3,186)	\$ 953,509
Highway Fund	369,431	—	13,871	383,302
Highway Trust Fund	(2,909)	—	(12,453)	(15,362)
Other Governmental Funds:				
Special Revenue Funds	2,494,795	—	3,186	2,497,981
Capital Projects Funds	209,514	—	—	209,514
Permanent Funds	58,550	—	—	58,550
Total Governmental Funds	3,050,572	1,035,504	1,418	4,087,494
Internal Service Funds	198,301	—	(2,823)	195,478
Government-wide adjustments:				
Capital assets	27,419,071	—	30,555	27,449,626
Unavailable deferred revenues	354,265	—	(5,214)	349,051
Long-term debt	(7,028,062)	—	3,355	(7,024,707)
Accrued interest payable	(85,512)	—	—	(85,512)
Pension assets	407	—	—	407
Total Government-wide adjustments	20,660,169	—	28,696	20,688,865
Total Governmental Activities	\$ 23,909,042	\$ 1,035,504	\$ 27,291	\$ 24,971,837
Business-type Activities - Enterprise Funds:				
Unemployment Compensation Fund	\$ 258,455	\$ —	\$ —	\$ 258,455
EPA Revolving Loan Fund	708,629	—	—	708,629
N.C. State Lottery Fund	—	—	—	—
Other enterprise funds	124,526	—	45	124,571
Total Business-type Activities - Enterprise Funds	\$ 1,091,610	\$ —	\$ 45	\$ 1,091,655
Component Units				
The Golden LEAF, Inc.	\$ 422,752	\$ —	\$ —	\$ 422,752
University of North Carolina System	8,746,529	—	1,135	8,747,664
Community Colleges	1,729,524	—	18,924	1,748,448
NC Housing Finance Agency	361,155	—	—	361,155
State Education Assistance Authority	546,471	—	—	546,471
Other component units	283,021	—	226	283,247
Total Component Units	\$ 12,089,452	\$ —	\$ 20,285	\$ 12,109,737

NOTES TO THE FINANCIAL STATEMENTS

NOTE 23: SUBSEQUENT EVENTS

Primary Government**Repair and Renovation Certificates of Participation**

On August 16, 2006, the State sold \$100 million of repair and renovation certificates of participation, Series 2006A. The certificates are dated August 16, 2006 and will bear interest from that date. Interest will be payable semiannually on each June 1 and December 1, commencing December 1, 2006. The certificates will mature, subject to the redemption provisions, from June 1, 2007 to 2026 inclusive, and were issued at coupon rates ranging from 4% to 5%. Pursuant to Session Law 2003-284 and the State of North Carolina Capital Facilities Finance Act, Article 9 of Chapter 142, the certificates were issued for the purpose of financing the repair and renovation of state facilities and related infrastructure that are supported from the State's General Fund and to pay certain costs incurred in connection with the execution and delivery of the 2006A Certificates.

Capital Improvement Certificates of Participation

On October 18, 2006, the State sold \$200 million of Capital improvements certificates of participation, Series 2006A. The certificates are dated October 18, 2006 and will bear interest from that date. Interest will be payable semiannually on each February 1 and August 1, commencing February 1, 2007. The certificates will mature, subject to the redemption provisions, from February 1, 2008 to 2027 inclusive, and were issued at coupon rates ranging from 4% to 5%. Pursuant to the provisions of Article 9 of Chapter 142 of the North Carolina General Statutes (the "State Capital Facilities Finance Act"), and Session Laws 2003-314, 2004-126, 2004-179, 2005-276, 2006-66, 2006-146 and 2006-231 which authorized a total of \$1.41 billion of various state projects and related infrastructure. These certificates were issued for the purpose of providing funding in varying amounts for the authorized projects and to pay certain costs incurred in connection with the execution and delivery of the 2006A Certificates.

Settlement Agreement

Subsequent to June 30, 2006, a settlement agreement was reached between the United States of America, through the United States Department of Justice and on behalf of the Office of Inspector General of the United States Department of Health and Human Services and the State of North Carolina for the Medicaid Disproportionate Share Hospital program. The settlement agreement was signed by all parties on August 17, 2006. The State agreed to pay \$151.5 million. Of that amount, fifty-one hospitals identified in the settlement paid the State \$91.5 million during September

2006. The first payment to the Centers for Medicare and Medicaid Services was made on September 27, 2006, in the amount of \$106.5 million. The second payment is due by September 30, 2007 in the amount of \$15 million plus accrued interest; the third payment is due by September 30, 2008 in the amount of \$15 million plus accrued interest; and the final payment is due by September 30, 2009 in the amount of \$15 million plus accrued interest. Interest shall begin accruing as of January 1, 2007 at the rate of 5.01%.

Town of Butner Water and Sewer

The authority to operate the Butner Water and Sewer System had been transferred from the Department of Health and Human Services (DHHS) to South Granville Water and Sewer Authority (SGWASA) effective as of January 1, 2006.

On July 5, 2006, the rights to the Town of Butner intangible asset, nitrogen credits were transferred to SGWASA and sold. The Town of Butner intangible asset, nitrogen credits amounting to \$1.46 million and the note payable amounting to \$1.46 million supporting the intangible asset, will be retired in fiscal year 2007.

Enacted legislation, Senate Bill 491 approved as of July 23, 2006, provides for the conveyance to SGWASA, from DHHS, on January 1, 2007, all the remaining assets that make up the water and sewer system providing that SGWASA "make arrangements to retire, assume or otherwise satisfy" the remaining bond payable, amounting to \$8.8 million entered into by the State and secured by the assets and revenue of the water and sewer system.

SGWASA will also continue to make monthly payments to the Town of Butner from its water and sewer revenue to provide for the funding of the operation of the Town.

Component Units**Appalachian State University**

The University participated in the University of North Carolina System Pool Revenue and Refunding Bonds, Series 2006A issuance. The Bonds were sold on November 30, 2006, and \$42.7 million will be used by the University for a new dining facility, renovate a residence hall, refund the 2000 housing bonds, refund a portion of the 2002A housing bonds, and refund a portion of the 2003A Student Recreation Center Bonds.

NOTES TO THE FINANCIAL STATEMENTS**North Carolina State University Commercial Paper**

On August 16, 2006, the University borrowed \$44 million through the commercial paper financing program for construction projects.

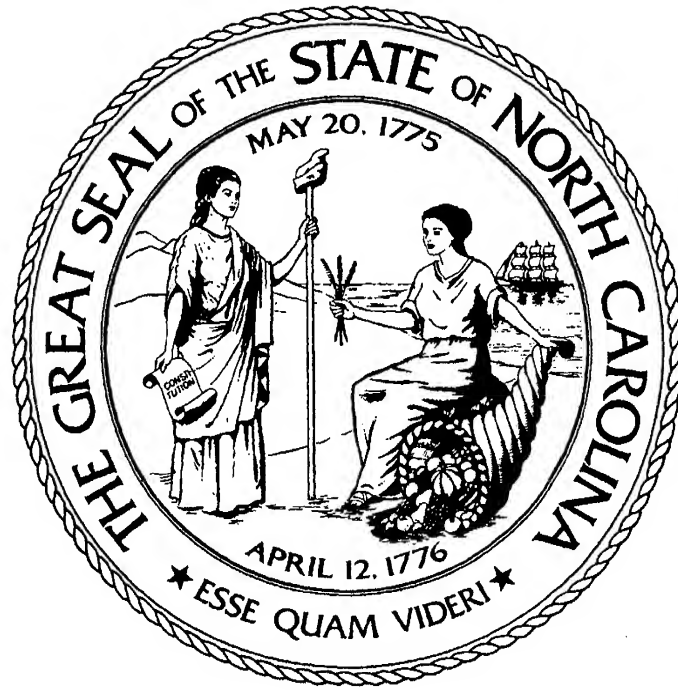
North Carolina Housing Finance Agency, Bond Purchase Agreement

On August 31, 2006, the Agency signed a bond purchase agreement under the 1998 Home Ownership Trust Indenture for Series 25A amounting to \$65 million. The Agency will deliver these bonds on September 26, 2006.

State Education Assistance Authority, Bond Issuance

On August 8, 2006 the State Education Assistance Authority (the Authority) issued \$346 million State of North Carolina Education Assistance Authority Tax-Exempt Guaranteed Student Loan Revenue Bonds 2006 Series Q (Senior Lien), \$30 million State of North Carolina Education Assistance Authority Tax-Exempt Guaranteed Student Loan Revenue Bonds 2006 Series Q (Subordinate Lien) and \$194 million State of North Carolina State Education Assistance Authority Guaranteed Student Loan Revenue Bonds 2006 Series R (Senior Lien). The proceeds from these issuances will be used to fund student loans.

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REQUIRED SUPPLEMENTARY INFORMATION

REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULES OF FUNDING PROGRESS
ALL DEFINED BENEFIT PENSION TRUST FUNDS

June 30, 2006

(Expressed in Thousands)

Retirement System	Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b) - (a) NOTE 1	Funded Ratio (a) / (b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
Teachers' and State Employees'	12-31-05	\$ 49,670,182	\$ 46,624,668	\$ (3,045,514)	106.5%	\$ 10,990,239	(27.7)%
	12-31-04	47,383,509	43,827,854	(3,555,655)	108.1%	10,366,137	(34.3)%
	12-31-03	45,117,508	41,733,701	(3,383,807)	108.1%	10,082,153	(33.6)%
	12-31-02	43,226,837	39,863,983	(3,362,854)	108.4%	9,734,448	(34.6)%
	12-31-01	42,104,086	37,713,663	(4,390,423)	111.6%	9,494,603	(46.2)%
	12-31-00	39,773,747	35,248,770	(4,524,977)	112.8%	9,001,354	(50.3)%
Consolidated Judicial	12-31-05	\$ 382,501	\$ 355,498	\$ (27,003)	107.6%	\$ 51,018	(52.9)%
	12-31-04	363,110	334,272	(28,838)	108.6%	49,368	(58.4)%
	12-31-03	340,857	316,649	(24,208)	107.6%	49,465	(48.9)%
	12-31-02	323,384	301,031	(22,353)	107.4%	48,432	(46.2)%
	12-31-01	311,221	285,692	(25,529)	108.9%	47,773	(53.4)%
	12-31-00	291,807	269,181	(22,626)	108.4%	43,546	(52.0)%
Legislative	12-31-05	\$ 28,381	\$ 21,524	\$ (6,857)	131.9%	\$ 3,681	(186.3)%
	12-31-04	27,478	20,696	(6,782)	132.8%	3,658	(185.4)%
	12-31-03	26,327	20,046	(6,281)	131.3%	3,692	(170.1)%
	12-31-02	25,304	19,243	(6,061)	131.5%	3,668	(165.2)%
	12-31-01	24,231	18,551	(5,680)	130.6%	3,691	(153.9)%
	12-31-00	22,314	17,733	(4,581)	125.8%	3,785	(121.0)%
Firemen's and Rescue Squad Workers'	6-30-05	\$ 274,265	\$ 285,356	\$ 11,091	96.1%	N/A	N/A
	6-30-04	261,148	273,826	12,678	95.4%	N/A	N/A
	6-30-03	249,925	260,707	10,782	95.9%	N/A	N/A
	6-30-02	239,918	249,316	9,398	96.2%	N/A	N/A
	6-30-01	225,276	230,796	5,520	97.6%	N/A	N/A
	6-30-00 A	202,751	240,335	37,584	84.4%	N/A	N/A
North Carolina National Guard	12-31-05	\$ 59,204	\$ 81,803	\$ 22,599	72.4%	N/A	N/A
	12-31-04	54,069	93,388	39,319	57.9%	N/A	N/A
	12-31-03	51,316	58,752	7,436	87.3%	N/A	N/A
	12-31-02	46,769	58,943	12,174	79.3%	N/A	N/A
	12-31-01	46,314	52,235	5,921	88.7%	N/A	N/A
	12-31-00	43,886	49,495	5,609	88.7%	N/A	N/A
Registers of Deeds' NOTE 2	12-31-05	\$ 28,242	\$ 11,788	\$ (16,454)	239.6%	\$ 5,367	(306.6)%
	12-31-04	24,262	12,240	(12,022)	198.2%	5,549	(216.6)%
	12-31-03	20,439	11,886	(8,553)	172.0%	5,178	(165.2)%
	12-31-02	16,325	11,673	(4,652)	139.9%	4,767	(97.6)%
	12-31-01	12,887	11,648	(1,239)	110.6%	4,736	(26.2)%
	12-31-99	9,227	10,859	1,632	85.0%	4,406	37.0%
Local Governmental Employees'	12-31-05	\$ 14,395,849	\$ 14,480,208	\$ 84,359	99.4%	\$ 4,241,334	2.0%
	12-31-04	13,377,297	13,466,189	88,892	99.3%	4,088,170	2.2%
	12-31-03	12,364,380	12,455,503	91,123	99.3%	3,898,476	2.3%
	12-31-02	11,393,460	11,462,706	69,246	99.4%	3,746,396	1.9%
	12-31-01	10,764,032	10,836,460	72,428	99.3%	3,597,769	2.0%
	12-31-00	9,892,805	9,967,548	74,743	99.3%	3,344,615	2.2%

NOTE 1 A negative UAAL denotes excess actuarial assets**NOTE 2** No valuation was done for 12-30-00

A- Change in the actuary's computation of the 5-year smoothed market value of assets.

N/A - Not applicable

The information presented in these required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information for the latest actuarial valuations is presented on page 124.

REQUIRED SUPPLEMENTARY INFORMATION**SCHEDULE OF CONTRIBUTIONS FROM THE EMPLOYERS AND OTHER CONTRIBUTING ENTITIES****ALL DEFINED BENEFIT PENSION TRUST FUNDS**

For the Six-Year Period 2001 to 2006 (July 1 to June 30)

(Expressed in Thousands)

<i>Retirement System</i>	<i>State Fiscal Year</i>	<i>Annual Required Contribution</i>	<i>Percentage Contributed</i>	
Teachers' and State Employees'	2006	\$ 269,587	100%	Note 1
	2005	237,170	100%	
	2004	23,135	100%	
	2003	—	NR	
	2002	196,003	100%	
	2001	513,907	76%	
Consolidated Judicial	2006	\$ 6,448	100%	Note 2
	2005	6,513	100%	
	2004	5,583	100%	Note 1
	2003	5,993	100%	
	2002	7,003	100%	
	2001	9,071	75%	
Legislative	2006	\$ —	NR	
	2005	—	NR	
	2004	—	NR	
	2003	—	NR	
	2002	858	97%	
	2001	861	71%	
Firemen's and Rescue Squad Workers'	2006	\$ 7,926	100%	Note 1
	2005	7,521	100%	
	2004	6,801	100%	
	2003	6,856	100%	
	2002	10,027	100%	
	2001	12,105	92%	
North Carolina National Guard	2006	\$ 5,944	102%	Note 1
	2005	1,412	111%	
	2004	1,176	100%	
	2003	1,132	—	
	2002	1,542	58%	
	2001	2,075	100%	
Registers of Deeds' NOTE 3	2006	\$ —	NR	
	2005	29	10,458%	
	2004	286	1,158%	
	2003	1,722	197%	
	2002	1,722	128%	
	2001	1,826	98%	
Local Governmental Employees'	2006	\$ 226,665	100%	
	2005	216,097	100%	
	2004	208,092	100%	
	2003	233,753	100%	
	2002	192,170	100%	
	2001	179,238	100%	

NR- No contribution was required or made.

Note 1- The State made additional contributions not related to the ARC. The amounts were disclosed in the 2004 CAFR.

Note 2- The State made \$284 thousand in additional contributions not related to the ARC.

Note 3 For Registers, significant fees and collections are contributed. They are not directly related to the ARC.

The information presented in these required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information for the latest actuarial valuations is presented on page 124.

REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN
UNRESERVED FUND BALANCE — BUDGET AND ACTUAL (BUDGETARY BASIS — NON-GAAP)
GENERAL FUND

For the Fiscal Year Ended June 30, 2006

(Dollars in Thousands)

	Budgeted Amounts			Variance with
	Original	Final	Actual	Final Budget
Revenues:				
Taxes:				
Individual income.....	\$ 8,839,760	\$ 8,839,760	\$ 9,400,168	\$ 560,408
Corporate income.....	905,940	905,940	1,204,103	298,163
Sales and use.....	4,692,700	4,692,700	4,893,911	201,211
Franchise.....	493,800	493,800	477,055	(16,745)
Insurance.....	441,700	441,700	431,729	(9,971)
Beverage.....	195,950	195,950	200,845	4,895
Inheritance.....	137,900	137,900	133,379	(4,521)
Other.....	280,774	280,774	279,325	(1,449)
Non-Tax:				
Fees, licenses and fines.....	161,726	161,726	159,102	(2,624)
Investment income.....	74,800	74,800	119,144	44,344
Disproportionate share receipts.....	100,000	100,000	100,000	—
Other.....	238,691	238,691	223,029	(15,662)
Transfers in.....	252,558	252,558	252,558	—
Departmental:				
Federal funds.....	8,741,557	10,105,989	8,788,034	(1,317,955)
Local funds.....	977,982	1,048,968	1,004,847	(44,121)
Inter-agency grants and allocations.....	22,007	58,081	53,955	(4,126)
Intra-governmental transactions.....	1,446,246	1,825,350	1,747,322	(78,028)
Sales and services.....	78,785	88,348	91,408	3,060
Rental and lease of property.....	7,319	8,122	8,497	375
Fees, licenses and fines.....	472,023	327,985	326,703	(1,282)
Contributions, gifts and grants.....	92,092	590,372	595,910	5,538
Miscellaneous.....	83,706	96,061	51,343	(44,718)
Universities.....	780,830	1,018,064	986,452	(31,612)
Total Revenues.....	29,518,846	31,983,639	31,528,819	(454,820)
Expenditures:				
Current:				
General government.....	1,011,356	622,842	599,490	23,352
Primary and secondary education.....	7,657,836	9,036,931	8,177,233	859,698
Community Colleges.....	1,012,194	1,111,392	1,072,056	39,336
Health and human services.....	14,221,530	15,016,023	14,553,291	462,732
Environment and natural resources.....	389,209	426,101	374,202	51,899
Economic development.....	165,232	173,733	169,210	4,523
Public safety, corrections, and regulation.....	1,719,009	2,091,679	1,953,958	137,721
Transportation.....	200	200	200	—
Agriculture.....	75,179	87,501	81,832	5,669
Capital outlay.....	54,960	54,960	54,960	—
Debt service.....	581,838	587,469	565,461	22,008
Universities.....	2,995,426	3,154,928	3,117,668	37,260
Total Expenditures.....	29,883,969	32,363,759	30,719,561	1,644,198
Excess revenues over (under)				
expenditures.....	(365,123)	(380,120)	809,258	1,189,378
Transfers to reserves.....	—	—	(538,381)	(538,381)
Unreserved fund balances (budgetary				
basis) at July 1, 2005.....	478,509	478,509	478,509	—
Unreserved fund balances (budgetary				
basis) at June 30, 2006.....	<u>\$ 113,386</u>	<u>\$ 98,389</u>	<u>\$ 749,386</u>	<u>\$ 650,997</u>

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

BUDGETARY REPORTING

A. General Fund Budgetary Process

The State of North Carolina operates on a biennial budget cycle with separate annual departmental certified budgets adopted by the General Assembly on the cash basis of accounting for the General Fund.

The accompanying budgetary comparison schedule discloses the annual original budget and final budget for the General Fund. Actual amounts in the schedule are presented on the budgetary basis. Since the budgetary basis differs from generally accepted accounting principles (GAAP), a reconciliation between the budgetary basis and the GAAP basis is presented in section C below.

The legal level of budgetary control is essentially at the object level. However, departments and institutions may make changes at their discretion within the budget of each purpose between and among objects for supplies and materials, current obligations and services, fixed charges and other expenses, and capital outlay. Also, Chapter 116, Article 1, Part 2A of the General Statutes authorized the sixteen universities within the University of North Carolina System to apply for special responsibility status, which sets the legal level of budgetary control at the institution's budget code level. A budget code is a convention used in the State's accounting system to distinguish the type of fund and the responsible department or institution. Budget codes are also used to segregate certain purposes within departments or institutions. Institutions with special responsibility status must still have certain budget revisions, primarily those associated with unanticipated revenues, approved by the Office of State Budget and Management (OSBM). Additionally, universities must maintain programs and services in accordance with the guidelines established by the Board of Governors of the consolidated University of North Carolina System. All sixteen universities have applied for and received special responsibility status.

Generally, unexpended appropriations at the end of the fiscal year lapse and are reappropriated in the next fiscal year. However, in certain circumstances the OSBM will allow a department to carry forward appropriations for specifically identified expenditures that will be paid in the next fiscal year. This is accomplished by the department writing a check to itself and recording a budgetary expenditure. The check is deposited in the next fiscal year as a budgetary receipt.

A detailed listing of appropriation and departmental budget information is available for public inspection in the separately published "Budgetary Compliance Report" prepared by the Office of the State Controller, 3512 Bush Street, Raleigh, NC 27609-7509 and through the Office of State Budget and Management, 116 West Jones Street, Raleigh, NC 27603-8005.

B. Special Fund Budgetary Process

The major special revenue funds, which are the Highway Fund and Highway Trust Fund, do not have annual appropriated budgets.

C. Reconciliation of Budget/GAAP Reporting Differences

The *Schedule of Revenues, Expenditures and Changes in Unreserved Fund Balances – Budget and Actual (Budgetary Basis – Non-GAAP) – General Fund*, presents comparisons of the legally adopted budget (which is more fully described in section A, above) with actual data on a budgetary basis. Accounting principles applied to develop data on a budgetary basis differ significantly from those principles used to present financial statements in conformity with generally accepted accounting principles (GAAP). The following describes the major differences between budgetary financial data and GAAP financial data.

Entity differences. Certain funds not included in the annual budgetary statements but which have the characteristics of governmental funds are presented in the General Fund for GAAP purposes.

Basis differences. Budgetary funds are accounted for on the cash basis of accounting, while under GAAP the governmental funds use the modified accrual basis. Accrued revenues and expenditures are recognized in the GAAP financial statements.

Timing differences. A significant variance between budgetary practices and GAAP is the authorized carryforward of appropriated funds, which is described in section A.

The following table presents a reconciliation of resulting entity, basis, and timing differences in the fund balances (budgetary basis) at June 30, 2006 to the fund balances on a modified accrual basis (GAAP). Amounts are expressed in thousands.

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

	<u>General Fund</u>
Unreserved fund balance (budgetary basis), June 30, 2006.....	\$ 749,386
Reserved fund balance (budgetary basis),	
Savings.....	628,793
Repairs and renovation.....	222,229
Disproportionate share.....	19,304
Disaster relief.....	141,712
One North Carolina Fund.....	1,083
Job Development Investment Grant.....	7,798
Fund balance (budgetary basis).....	<u>\$ 1,770,305</u>
Reconciling Adjustments:	
Entity Differences:	
Primary government:	
Other.....	<u>232,759</u>
Basis Differences:	
Accrued revenues:	
Taxes receivable.....	1,790,815
Accounts receivable.....	256,676
Federal funds, net.....	774,608
Other receivables.....	210,775
Less:	
Tax refunds payable.....	(1,183,801)
Deferred revenue.....	(674,748)
Total accrued revenues.....	<u>1,174,325</u>
Accrued expenditures:	
Medical claims payable.....	(962,144)
Accounts payable and accrued liabilities.....	(480,337)
Other payables.....	(63,711)
Total accrued expenditures.....	<u>(1,506,192)</u>
Other Adjustments:	
Notes receivable.....	6,578
Inventories.....	73,343
Investments.....	52
Timing Differences:	
Authorized carryforward for specific encumbrances.....	31,858
Authorized carryforward for designated programs.....	<u>142,170</u>
Fund balance (GAAP basis) June 30, 2006.....	<u>\$1,925,198</u>

D. Budgetary Reserves

The North Carolina General Assembly has established several accounts in the General Fund as reserved fund balances for budgetary purposes. Funds that are transferred to these accounts from the unreserved credit balance of the General Fund can be used only for their intended purposes and on a budgetary basis are not available for appropriation.

Savings Reserve Account (General Statute 143-15.2 through 143-15.3B). One-fourth of any unreserved credit balance (budgetary basis) remaining in the General Fund at the end of each fiscal year will be transferred to the Savings Reserve account until the account contains funds equal to 5% of the amount appropriated the preceding year for the General Fund operating budget. Therefore, at the end of the fiscal year, \$316.15 million was transferred to the Savings Reserve bringing the balance of this reserve to \$628.79 million at June 30, 2006.

Repairs and Renovations Reserve Account (General Statute 143-15.2 through 143-15.3B). This reserve account provides for a portion of the State's continuing capital needs. The reserve balance is based on 3% of the estimated replacement value of all State buildings supported from the General Fund. The funds in this account shall be used only for the repair and renovation of State facilities and related infrastructure that are supported from the General Fund. In accordance with Session Law 2006-66, Senate Bill 1741, Section 2.2(b) the State Controller was directed to transfer \$222.23 million from the unreserved credit balance to the Repairs and Renovations Reserve Account on June 30, 2006. At the end of the fiscal year 2005-2006, the balance of this reserve was \$222.23 million.

Disproportionate Share Reserve Account (1997 General Assembly, Senate Bill 352, Section 11). Disproportionate share payments are Medicaid payments made to hospitals which serve a disproportionate share of indigent patients. This account was established to reserve for future appropriation any excess collection of disproportionate share revenues above those budgeted as departmental receipts or non-tax revenues. At the end of the fiscal year 2005-2006, the remaining balance of this reserve was \$19.3 million.

Disaster Relief Reserve. The 1996 Second Extra Session, Section 7.9, Chapter 18 of House Bill 53 authorized the Director of Budget to create the Disaster Relief Reserve. During fiscal year 2004-2005 \$248.17 million was transferred to the Disaster Relief Reserve to fund recovery from the effects of the 2004 Hurricane Season. This \$248.17 million was funded from required agency, university, and community college transfers, a Savings Reserve transfer, and transfers of funds from the unreserved credit balance. At the end of the fiscal year 2005-2006, the remaining balance of this reserve was \$141.71 million.

One North Carolina Reserve. The Office of State Budget and Management, after consultation with Joint Legislative Commission on Governmental Operations on November 4, 2003, established the One North Carolina Reserve. This reserve was funded by a transfer from the unexpended legislative increase appropriation of \$1.5 million. During the fiscal year an establishment of \$0.4 million was expended. However, since that time no further One North Carolina funds have been disbursed. Therefore, for fiscal years 2003-2004 through 2005-2006 the balance has remained at \$1.08 million.

Job Development Investment Grant Program Reserve (JDIG). In accordance with Session Law 2004-124, House Bill 1414, Section 6.12.(a), Article 1 of Chapter 143 of the General Statutes was amended by adding a new section requiring the establishment of a JDIG Reserve in the General Fund. It is the intent of the General Assembly to annually appropriate funds to this reserve in amounts sufficient to meet anticipated cash requirements for each fiscal year of the Job Development Investment Grant Program established pursuant to General Statute 143B-437.52. Funds in the amount of \$4.5 million were

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

appropriated for fiscal year 2004-2005, \$9 million for fiscal year 2005-2006, and \$12.4 million for fiscal year 2006-2007.

At the end of fiscal year 2005-2006, the balance of this reserver was \$7.8 million.

The following schedule summarizes current year changes in the budgetary reserve accounts. Amounts are expressed in thousands.

General Fund Reserved Fund Balance	Balance June 30, 2005	Transfers from General Fund Unreserved Fund Balance	Transfers to General Fund Unreserved Fund Balance	Balance June 30, 2006
Savings[1].....	\$ 312,641	\$ 316,152	\$ —	\$ 628,793
Repairs and renovations.....	125,000	222,229	(125,000)	222,229
Disproportionate share.....	19,304	—	—	19,304
Disaster relief.....	211,679	—	(69,967)	141,712
One North Carolina.....	1,083	—	—	1,083
Job Development Investment Grant.....	2,542	9,000	(3,744)	7,798
Total.....	<u>\$ 672,249</u>	<u>\$ 547,381</u>	<u>\$ (198,711)</u>	<u>\$ 1,020,919</u>

[1] Note: An additional \$5.79 million was transferred by the State Controller on December 5, 2006, to the Savings Reserve account from the General Fund unreserved fund balance. This additional transfer will satisfy the 2006 fiscal year end Savings Reserve account requirements of General Statute 143-15.2 through 143-15.3B.

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*COMBINING FUND
STATEMENTS
AND
SCHEDULES*

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*NONMAJOR
GOVERNMENTAL
FUNDS*

**COMBINING BALANCE SHEET
NONMAJOR GOVERNMENTAL FUNDS**

June 30, 2006

Exhibit C-1

(Dollars in Thousands)

	Special Revenue Funds	Capital Projects Funds	Permanent Funds	Total Nonmajor Governmental Funds
Assets				
Cash and cash equivalents	\$ 1,336,214	\$ 240,604	\$ 1,134	\$ 1,577,952
Investments	989,983	28,532	—	1,018,515
Securities lending collateral	975,533	886	32,973	1,009,392
Receivables, net:				
Taxes receivable	2,317	—	—	2,317
Accounts receivable	24,205	—	12	24,217
Intergovernmental receivable	7,092	353	—	7,445
Interest receivable	7,426	4	3	7,433
Due from other funds	49,541	8,386	—	57,927
Due from component units	9,240	—	—	9,240
Inventories	33,818	—	—	33,818
Prepaid items	991	—	—	991
Advances to component units	21,742	—	—	21,742
Notes receivable, net	334,362	—	—	334,362
Securities held in trust	38,800	—	—	38,800
Endowment investments	—	—	57,741	57,741
Total Assets	<u>\$ 3,831,264</u>	<u>\$ 278,765</u>	<u>\$ 91,863</u>	<u>\$ 4,201,892</u>
Liabilities and Fund Balances				
Liabilities:				
Accounts payable and accrued liabilities:				
Accounts payable	\$ 61,359	\$ 24,104	\$ —	\$ 85,463
Accrued payroll	813	—	—	813
Intergovernmental payable	9,105	653	—	9,758
Claims payable	32,632	—	—	32,632
Obligations under securities lending	975,533	886	32,973	1,009,392
Due to fiduciary funds	47	—	—	47
Due to other funds	41,815	38	—	41,853
Due to component units	95,280	—	—	95,280
Deferred revenue	13,282	—	—	13,282
Deposits payable	8	1	—	9
Funds held for others	38,863	—	—	38,863
Total Liabilities	<u>1,268,737</u>	<u>25,682</u>	<u>32,973</u>	<u>1,327,392</u>
Fund Balances:				
Reserved	706,386	139,650	57,372	903,408
Unreserved	1,856,141	113,433	1,518	1,971,092
Total Fund Balances	<u>2,562,527</u>	<u>253,083</u>	<u>58,890</u>	<u>2,874,500</u>
Total Liabilities and Fund Balances	<u>\$ 3,831,264</u>	<u>\$ 278,765</u>	<u>\$ 91,863</u>	<u>\$ 4,201,892</u>

**COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
NONMAJOR GOVERNMENTAL FUNDS**

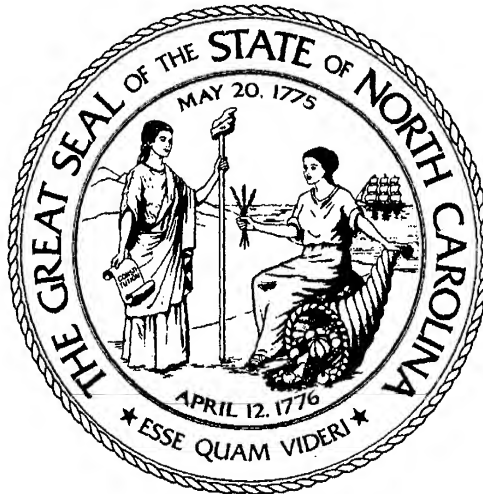
For the Fiscal Year Ended June 30, 2006

Exhibit C-2

(Dollars in Thousands)

	Special Revenue Funds	Capital Projects Funds	Permanent Funds	Total Nonmajor Governmental Funds
Revenues:				
Taxes:				
Individual income tax.....	\$ 1,735	\$ —	\$ —	\$ 1,735
Corporate income tax.....	98,199	—	—	98,199
Sales and use tax.....	26,836	—	—	26,836
Gasoline tax.....	27,927	—	—	27,927
Insurance tax.....	10,568	—	—	10,568
Beverage tax.....	328	—	—	328
Other taxes.....	146,734	—	—	146,734
Federal funds.....	395,586	20,390	—	415,976
Local funds.....	19,447	—	—	19,447
Investment earnings.....	78,436	1,502	(189)	79,749
Interest earnings on loans.....	5,398	—	—	5,398
Sales and services.....	163,421	1,057	69	164,547
Rental and lease of property.....	3,158	49	—	3,207
Fees, licenses, and fines.....	196,308	—	4,569	200,877
Contributions, gifts, and grants.....	24,595	73,858	36	98,489
Funds escheated.....	108,075	—	—	108,075
Miscellaneous.....	13,506	362	—	13,868
Total revenues.....	1,320,257	97,218	4,485	1,421,960
Expenditures:				
Current:				
General government.....	94,807	—	—	94,807
Primary and secondary education.....	257,079	—	—	257,079
Higher education.....	411,372	33	26	411,431
Health and human services.....	87,989	—	9	87,998
Economic development.....	400,557	—	—	400,557
Environment and natural resources.....	375,281	35	1,434	376,750
Public safety, corrections, and regulation.....	397,251	—	—	397,251
Agriculture.....	8,370	—	—	8,370
Capital outlay.....	—	270,882	—	270,882
Debt service:				
Principal retirement.....	747	—	—	747
Interest and fees.....	902	135	—	1,037
Debt issuance costs.....	1,137	—	—	1,137
Total expenditures.....	2,035,492	271,085	1,469	2,308,046
Excess revenues over (under) expenditures.....	(715,235)	(173,867)	3,016	(886,086)
Other Financing Sources (Uses):				
Bonds issued.....	370,000	—	—	370,000
Other debt issued.....	—	23,831	—	23,831
Premium on debt issued.....	16,338	—	—	16,338
Capital leases.....	26,745	—	—	26,745
Sale of capital assets.....	5,464	10	—	5,474
Insurance recoveries.....	923	—	—	923
Transfers in.....	875,654	195,129	680	1,071,463
Transfers out.....	(516,099)	(1,534)	(3,356)	(520,989)
Total other financing sources (uses).....	779,025	217,436	(2,676)	993,785
Net change in fund balances.....	63,790	43,569	340	107,699
Fund balances — July 1, as restated.....	2,497,981	209,514	58,550	2,766,045
Increase (decrease) in reserve for related assets.....	756	—	—	756
Fund balances — June 30.....	\$ 2,562,527	\$ 253,083	\$ 58,890	\$ 2,874,500

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NONMAJOR SPECIAL REVENUE FUNDS

The special revenue funds are maintained to account for those financial resources which are restricted by legal, regulatory or administrative action to finance particular functions or activities of the State.

The following are included in the nonmajor special revenue funds:

- Escheat Fund
- Health and Wellness Trust Fund
- Tobacco Trust Fund
- Clean Water Funds
- Public School Bond Fund
- Higher Education and Public Improvement Bond Funds
- Public School Building Capital Fund
- Clean Water Management Trust Fund
- N.C. Infrastructure Finance Corporation
- Natural Gas Funds
- Prison Enterprises Fund
- Educational Materials and School Buses Fund
- Employment Security Commission Funds
- Highway Patrol Fund
- Employment and Training Administration Fund
- Leaking Petroleum Underground Storage Tank Cleanup Fund
- Ecosystem Enhancement Funds
- Wildlife Resources Commission Fund
- Natural Heritage Trust Fund
- Wireless 911 Fund
- Parks and Recreation Trust Fund
- Education Lottery Funds
- Departmental Funds

**COMBINING BALANCE SHEET
NONMAJOR SPECIAL REVENUE FUNDS**

June 30, 2006

(Dollars in Thousands)

	Escheat Fund	Health and Wellness Trust Fund	Tobacco Trust Fund	Clean Water Funds	Public School Bond Fund	Higher Education and Public Improvement Bond Funds	Public School Building Capital Fund	Clean Water Management Trust Fund
Assets								
Cash and cash equivalents	\$223,222	\$ 46,941	\$ 5,100	\$ 40,095	\$ 10,132	\$ 203	\$125,007	\$ 175,139
Investments	336,371	—	—	60,350	1,887	444,482	—	—
Securities lending collateral	334,534	40,286	4,375	26,191	—	—	131,857	150,262
Receivables, net:								
Taxes receivable.....	—	—	—	—	—	—	—	—
Accounts receivable.....	—	—	16	4	—	—	—	—
Intergovernmental receivable.....	—	—	—	—	—	—	—	—
Interest receivable.....	782	176	—	1,067	46	1,326	513	573
Due from other funds	—	—	—	—	—	24,812	—	—
Due from component units	8,728	—	—	—	—	—	—	—
Inventories.....	—	—	—	—	—	—	—	—
Prepaid items.....	—	—	—	—	—	—	—	—
Advances to component units	21,742	—	—	—	—	—	—	—
Notes receivable, net.....	—	—	—	115,964	—	—	—	—
Securities held in trust.....	—	—	—	—	—	—	—	—
Total Assets.....	\$925,379	\$ 87,403	\$ 9,491	\$ 243,671	\$ 12,065	\$ 470,823	\$257,377	\$ 325,974
Liabilities and Fund Balances								
Liabilities:								
Accounts payable and accrued liabilities:								
Accounts payable.....	\$ 19	\$ 2	\$ 15	\$ 558	\$ —	\$ —	\$ —	\$ 518
Accrued payroll.....	—	—	—	—	—	—	—	—
Intergovernmental payable.....	—	—	—	31	—	—	—	320
Claims payable.....	32,632	—	—	—	—	—	—	—
Obligations under securities lending.....	334,534	40,286	4,375	26,191	—	—	131,857	150,262
Due to fiduciary funds	—	—	—	—	—	—	—	—
Due to other funds	—	2	—	—	—	24,805	—	8
Due to component units	24,726	—	—	—	—	51,810	—	—
Deferred revenue.....	11,394	—	—	—	—	—	—	—
Deposits payable.....	—	—	—	—	—	—	—	—
Funds held for others.....	—	—	—	—	—	—	—	—
Total Liabilities.....	403,305	40,290	4,390	26,780	—	76,615	131,857	151,108
Fund Balances:								
Reserved for:								
Inventories.....	—	—	—	—	—	—	—	—
Notes receivable.....	—	—	—	115,964	—	—	—	—
Prepaid items.....	—	—	—	—	—	—	—	—
Loan and grant commitments.....	—	—	—	16,895	—	—	—	139,464
Advance to component unit.....	21,742	—	—	—	—	—	—	—
Other purposes.....	—	—	—	—	—	—	—	—
Unreserved:								
Undesignated.....	500,332	47,113	5,101	84,032	12,065	394,208	125,520	35,402
Total Fund Balances.....	522,074	47,113	5,101	216,891	12,065	394,208	125,520	174,866
Total Liabilities and Fund Balances.....	\$925,379	\$ 87,403	\$ 9,491	\$ 243,671	\$ 12,065	\$ 470,823	\$257,377	\$ 325,974

Exhibit C-3

N.C. Infrastructure Finance Corporation	Natural Gas Funds	Prison Enterprises Fund	Educational Materials and School Buses Fund	Employment Security Commission Funds	Highway Patrol Fund	Employment and Training Administration Fund	Leaking Petroleum Underground Storage Tank Cleanup Fund	Ecosystem Enhancement Funds
\$ —	\$ 2,334	\$ 20,701	\$ 66,249	\$ 11,113	\$ 17,343	\$ 68	\$ 18,988	\$ 45,393
141,680	1,321	—	—	—	—	—	—	—
—	3,135	—	—	—	2,092	—	15,911	39,095
—	—	—	—	—	—	—	1,593	—
—	—	1,138	56	1,005	628	2	449	—
—	—	205	766	767	8	—	—	—
—	6	—	—	—	—	—	54	166
—	—	6,459	—	—	—	—	—	—
—	—	3	—	—	—	—	—	—
—	—	15,080	9,237	370	3,975	—	—	—
—	—	—	—	328	—	—	—	—
—	—	—	—	—	—	—	—	—
—	198,679	—	—	—	—	—	681	—
—	—	—	—	—	—	—	—	—
<u>\$ 141,680</u>	<u>\$ 205,475</u>	<u>\$ 43,586</u>	<u>\$ 76,308</u>	<u>\$ 13,583</u>	<u>\$ 24,046</u>	<u>\$ 70</u>	<u>\$ 37,676</u>	<u>\$ 84,654</u>
\$ —	\$ —	\$ 4,280	\$ 25,165	\$ 2,503	\$ 6,709	\$ 19	\$ 5,654	\$ 3,513
—	—	23	—	138	6	—	—	—
—	—	1	10	511	2	—	11	—
—	—	—	—	—	—	—	—	—
—	3,135	—	—	—	2,092	—	15,911	39,095
—	—	—	—	—	—	—	—	—
8,547	—	110	—	265	128	9	—	13
10,565	—	—	—	—	—	—	—	—
—	—	439	—	—	599	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
<u>19,112</u>	<u>3,135</u>	<u>4,853</u>	<u>25,175</u>	<u>3,417</u>	<u>9,536</u>	<u>28</u>	<u>21,576</u>	<u>42,621</u>
—	—	15,080	9,237	370	3,975	—	—	—
—	198,679	—	—	—	—	—	681	—
—	—	—	—	328	—	—	—	—
—	—	—	—	—	—	—	—	74,837
—	—	—	—	—	—	—	—	—
—	—	685	—	—	—	—	—	—
<u>122,568</u>	<u>3,661</u>	<u>22,968</u>	<u>41,896</u>	<u>9,468</u>	<u>10,535</u>	<u>42</u>	<u>15,419</u>	<u>(32,804)</u>
<u>122,568</u>	<u>202,340</u>	<u>38,733</u>	<u>51,133</u>	<u>10,166</u>	<u>14,510</u>	<u>42</u>	<u>16,100</u>	<u>42,033</u>
<u>\$ 141,680</u>	<u>\$ 205,475</u>	<u>\$ 43,586</u>	<u>\$ 76,308</u>	<u>\$ 13,583</u>	<u>\$ 24,046</u>	<u>\$ 70</u>	<u>\$ 37,676</u>	<u>\$ 84,654</u>

Continued

**COMBINING BALANCE SHEET
NONMAJOR SPECIAL REVENUE FUNDS**

June 30, 2006

Exhibit C-3

(Dollars in Thousands)

	Wildlife Resources Commission Fund	Natural Heritage Trust Fund	Wireless 911 Fund	Parks and Recreation Trust Fund	Education Lottery Funds	Departmental Funds	Total Nonmajor Special Revenue Funds
Assets							
Cash and cash equivalents	\$ 7,915	\$ 26,302	\$ 18,852	\$ 52,837	\$ 50,000	\$ 372,280	\$ 1,336,214
Investments	—	—	—	—	—	3,892	989,983
Securities lending collateral	5,056	21,201	16,171	—	42,761	142,606	975,533
Receivables, net:							
Taxes receivable.....	—	—	—	—	—	724	2,317
Accounts receivable.....	686	403	6,613	133	—	13,072	24,205
Intergovernmental receivable.....	1,663	—	—	—	—	3,683	7,092
Interest receivable.....	16	80	62	—	10	2,549	7,426
Due from other funds	—	—	—	168	13,548	4,554	49,541
Due from component units	—	—	—	—	—	509	9,240
Inventories.....	2,253	—	—	—	—	2,903	33,818
Prepaid items.....	—	—	—	—	—	663	991
Advances to component units	—	—	—	—	—	—	21,742
Notes receivable, net.....	—	—	—	—	—	19,038	334,362
Securities held in trust.....	—	—	—	—	—	38,800	38,800
Total Assets.....	\$ 17,589	\$ 47,986	\$ 41,698	\$ 53,138	\$ 106,319	\$ 605,273	\$ 3,831,264
Liabilities and Fund Balances							
Liabilities:							
Accounts payable and accrued liabilities:							
Accounts payable.....	\$ 1,705	\$ —	\$ 24	\$ 168	\$ —	\$ 10,507	\$ 61,359
Accrued payroll.....	205	—	—	—	—	441	813
Intergovernmental payable.....	—	—	6,505	299	—	1,415	9,105
Claims payable.....	—	—	—	—	—	—	32,632
Obligations under securities lending.....	5,056	21,201	16,171	—	42,761	142,606	975,533
Due to fiduciary funds	—	—	—	—	—	47	47
Due to other funds	401	—	1,461	—	—	6,066	41,815
Due to component units	—	—	—	—	—	8,179	95,280
Deferred revenue.....	—	—	—	—	—	850	13,282
Deposits payable.....	—	—	—	—	—	8	8
Funds held for others.....	—	—	—	—	—	38,863	38,863
Total Liabilities.....	7,367	21,201	24,161	467	42,761	208,982	1,268,737
Fund Balances:							
Reserved for:							
Inventories.....	2,253	—	—	—	—	2,903	33,818
Notes receivable.....	—	—	—	—	—	19,038	334,362
Prepaid items.....	—	—	—	—	—	663	991
Loan and grant commitments.....	—	22,829	—	33,032	—	38	287,095
Advance to component unit.....	—	—	—	—	—	—	21,742
Other purposes.....	7,969	—	—	—	—	19,724	28,378
Unreserved:							
Undesignated.....	—	3,956	17,537	19,639	63,558	353,925	1,856,141
Total Fund Balances.....	10,222	26,785	17,537	52,671	63,558	396,291	2,562,527
Total Liabilities and Fund Balances.....	\$ 17,589	\$ 47,986	\$ 41,698	\$ 53,138	\$ 106,319	\$ 605,273	\$ 3,831,264

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COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES NONMAJOR SPECIAL REVENUE FUNDS

For the Fiscal Year Ended June 30, 2006

(Dollars in Thousands)

	Escheat Fund	Health and Wellness Trust Fund	Tobacco Trust Fund	Clean Water Funds	Public School Bond Fund	Higher Education and Public Improvement Bond Funds	Public School Building Capital Fund	Clean Water Management Trust Fund
Revenues:								
Taxes:								
Individual income tax.....	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Corporate income tax.....	—	—	—	—	—	—	98,199	—
Sales and use tax.....	—	—	—	—	—	—	—	—
Gasoline tax.....	—	—	—	—	—	—	—	—
Insurance tax.....	—	—	—	—	—	—	—	—
Beverage tax.....	—	—	—	—	—	—	—	—
Other taxes.....	—	—	—	—	—	—	—	—
Federal funds.....	—	—	—	351	—	—	—	—
Local funds.....	—	—	—	—	—	—	—	—
Investment earnings.....	2,402	2,596	419	3,653	521	16,210	10,554	11,340
Interest earnings on loans.....	—	—	—	4,464	—	—	—	—
Sales and services.....	—	—	—	—	—	—	—	—
Rental and lease of property.....	—	—	—	—	—	—	—	—
Fees, licenses, and fines.....	—	—	—	—	—	—	—	—
Contributions, gifts, and grants.....	—	—	—	—	—	—	—	—
Funds escheated.....	108,075	—	—	—	—	—	—	—
Miscellaneous.....	—	—	—	—	—	—	—	—
Total revenues.....	<u>110,477</u>	<u>2,596</u>	<u>419</u>	<u>8,468</u>	<u>521</u>	<u>16,210</u>	<u>108,753</u>	<u>11,340</u>
Expenditures:								
Current:								
General government.....	15,559	—	—	—	12	345	—	—
Primary and secondary education.....	—	—	—	—	4,625	—	80,434	—
Higher education.....	64,719	—	—	—	—	291,443	—	—
Health and human services.....	—	17,923	—	—	—	—	—	—
Economic development.....	—	—	—	38,012	—	—	—	—
Environment and natural resources.....	—	—	—	29,709	—	—	—	57,030
Public safety, corrections, and regulation....	—	—	—	—	—	—	—	—
Agriculture.....	—	—	2,069	—	—	—	—	—
Debt service:								
Principal retirement.....	—	—	—	—	—	—	—	—
Interest and fees.....	—	—	—	—	—	—	—	—
Debt issuance costs.....	—	—	—	252	—	597	—	—
Total expenditures.....	<u>80,278</u>	<u>17,923</u>	<u>2,069</u>	<u>67,973</u>	<u>4,637</u>	<u>292,385</u>	<u>80,434</u>	<u>57,030</u>
Excess revenues over (under) expenditures....	<u>30,199</u>	<u>(15,327)</u>	<u>(1,650)</u>	<u>(59,505)</u>	<u>(4,116)</u>	<u>(276,175)</u>	<u>28,319</u>	<u>(45,690)</u>
Other Financing Sources (Uses):								
Bonds issued.....	—	—	—	70,000	—	300,000	—	—
Premium on debt issued.....	—	—	—	638	—	15,700	—	—
Capital leases.....	—	—	—	—	—	—	—	—
Sale of capital assets.....	—	—	—	—	—	—	—	—
Insurance recoveries.....	—	—	—	—	—	—	—	—
Transfers in.....	—	44,113	34,113	56,189	—	—	4	100,000
Transfers out.....	(18,279)	(26,720)	(34,113)	(14,344)	(34)	(124,684)	(4,012)	(775)
Total other financing sources (uses).....	<u>(18,279)</u>	<u>17,393</u>	<u>—</u>	<u>112,483</u>	<u>(34)</u>	<u>191,016</u>	<u>(4,008)</u>	<u>99,225</u>
Net change in fund balances.....	<u>11,920</u>	<u>2,066</u>	<u>(1,650)</u>	<u>52,978</u>	<u>(4,150)</u>	<u>(85,159)</u>	<u>24,311</u>	<u>53,535</u>
Fund balances — July 1, as restated.....	510,154	45,047	6,751	163,913	16,215	479,367	101,209	121,331
Increase (decrease) in reserve for related assets.....	—	—	—	—	—	—	—	—
Fund balances — June 30.....	<u>\$ 522,074</u>	<u>\$ 47,113</u>	<u>\$ 5,101</u>	<u>\$ 216,891</u>	<u>\$ 12,065</u>	<u>\$ 394,208</u>	<u>\$ 125,520</u>	<u>\$ 174,866</u>

Exhibit C-4

N.C. Infrastructure Finance Corporation	Natural Gas Funds	Prison Enterprises Fund	Educational Materials and School Buses Fund	Employment Security Commission Funds	Highway Patrol Fund	Employment and Training Administration Fund	Leaking Petroleum Underground Storage Tank Cleanup Fund	Ecosystem Enhancement Funds
\$	\$	\$	\$	\$	\$	\$	\$	\$
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	18,006	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	185,015	331	119,357	—	—
—	—	—	—	16,854	—	—	—	—
8,631	1,343	—	—	—	191	—	787	4,148
—	—	—	—	—	—	—	1	—
—	—	76,497	13,635	—	1,147	1	—	—
—	—	—	1,517	—	—	—	—	—
—	—	—	—	4,724	765	—	7,875	44,741
—	—	—	—	3,446	302	—	—	—
—	—	—	—	—	—	—	—	—
—	—	120	—	650	52	—	—	—
8,631	1,343	76,617	15,152	210,689	2,788	119,358	26,669	48,889
—	—	—	—	—	—	—	—	—
—	—	—	123,727	—	—	—	—	—
45,890	—	—	—	—	—	—	—	—
—	13,849	—	—	216,652	—	119,205	—	—
—	—	—	—	—	—	—	15,487	66,436
—	—	79,528	—	—	203,023	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
120	—	—	—	—	—	—	—	—
288	—	—	—	—	—	—	—	—
46,298	13,849	79,528	123,727	216,652	203,023	119,205	15,487	66,436
(37,667)	(12,506)	(2,911)	(108,575)	(5,963)	(200,235)	153	11,182	(17,547)
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—
—	—	287	1,410	—	3,510	—	—	—
—	—	—	—	—	922	—	—	—
—	—	250	124,116	11,683	202,254	—	5,673	36
(80,375)	(1,200)	(3,844)	(690)	(4,173)	(1,708)	(131)	(4,055)	(2,010)
(80,375)	(1,200)	(3,307)	124,836	7,510	204,978	(131)	1,618	(1,974)
(118,042)	(13,706)	(6,218)	16,261	1,547	4,743	22	12,800	(19,521)
240,610	216,046	43,200	36,681	8,536	10,107	20	3,300	61,554
—	—	1,751	(1,809)	83	(340)	—	—	—
\$ 122,568	\$ 202,340	\$ 38,733	\$ 51,133	\$ 10,166	\$ 14,510	\$ 42	\$ 16,100	\$ 42,033

Continued

COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES NONMAJOR SPECIAL REVENUE FUNDS

For the Fiscal Year Ended June 30, 2006

Exhibit C-4

(Dollars in Thousands)

	Wildlife Resources Commission Fund	Natural Heritage Trust Fund	Wireless 911 Fund	Parks and Recreation Trust Fund	Education Lottery Funds	Departmental Funds	Total Nonmajor Special Revenue Funds
Revenues:							
Taxes:							
Individual income tax.....	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 1,735	\$ 1,735
Corporate income tax.....	—	—	—	—	—	—	98,199
Sales and use tax.....	18,573	—	—	—	—	8,263	26,836
Gasoline tax.....	1,735	—	—	—	—	8,186	27,927
Insurance tax.....	—	—	—	—	—	10,568	10,568
Beverage tax.....	—	—	—	—	—	328	328
Other taxes.....	—	18,780	51,674	56,338	—	19,942	146,734
Federal funds.....	12,535	—	—	—	—	77,997	395,586
Local funds.....	171	—	—	—	—	2,422	19,447
Investment earnings.....	489	1,832	922	—	22	12,376	78,436
Interest earnings on loans.....	—	—	—	—	—	933	5,398
Sales and services.....	3,324	—	454	—	—	68,363	163,421
Rental and lease of property.....	26	—	—	—	—	1,615	3,158
Fees, licenses, and fines.....	19,716	4,026	—	1,327	—	113,134	196,308
Contributions, gifts, and grants.....	501	—	—	—	—	20,346	24,595
Funds escheated.....	—	—	—	—	—	—	108,075
Miscellaneous.....	98	—	—	—	—	12,586	13,506
Total revenues.....	57,168	24,638	53,050	57,665	22	358,794	1,320,257
Expenditures:							
Current:							
General government.....	—	—	—	—	—	78,891	94,807
Primary and secondary education.....	—	—	—	—	11	48,282	257,079
Higher education.....	—	—	—	—	—	9,320	411,372
Health and human services.....	—	—	—	—	—	70,066	87,989
Economic development.....	—	—	—	—	—	12,839	400,557
Environment and natural resources.....	59,554	22,251	—	40,480	—	84,334	375,281
Public safety, corrections, and regulation.....	—	—	36,303	—	—	78,397	397,251
Agriculture.....	—	—	—	—	—	6,301	8,370
Debt service:							
Principal retirement.....	650	—	—	—	—	97	747
Interest and fees.....	782	—	—	—	—	—	902
Debt issuance costs.....	—	—	—	—	—	—	1,137
Total expenditures.....	60,986	22,251	36,303	40,480	11	388,527	2,035,492
Excess revenues over (under) expenditures.....	(3,818)	2,387	16,747	17,185	11	(29,733)	(715,235)
Other Financing Sources (Uses):							
Bonds issued.....	—	—	—	—	—	—	370,000
Premium on debt issued.....	—	—	—	—	—	—	16,338
Capital leases.....	—	—	—	—	—	26,745	26,745
Sale of capital assets.....	163	—	—	—	—	94	5,464
Insurance recoveries.....	—	—	—	—	—	1	923
Transfers in.....	3,397	—	—	200	63,547	230,079	875,654
Transfers out.....	(5,573)	(194)	(6,843)	(3,753)	—	(178,589)	(516,099)
Total other financing sources (uses).....	(2,013)	(194)	(6,843)	(3,553)	63,547	78,330	779,025
Net change in fund balances.....	(5,831)	2,193	9,904	13,632	63,558	48,597	63,790
Fund balances — July 1, as restated.....	14,930	24,592	7,633	39,039	—	347,746	2,497,981
Increase (decrease) in reserve for related assets.....	1,123	—	—	—	—	(52)	756
Fund balances — June 30.....	\$ 10,222	\$ 26,785	\$ 17,537	\$ 52,671	\$ 63,558	\$ 396,291	\$ 2,562,527

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**COMBINING SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN UNRESERVED
FUND BALANCES — BUDGET AND ACTUAL (BUDGETARY BASIS — NON-GAAP)
NONMAJOR SPECIAL REVENUE FUNDS**

For the Fiscal Year Ended June 30, 2006

(Dollars in Thousands)

	Employment and Training Administration Fund				Clean Water Funds			
	<u>Budgeted Amounts</u>		<u>Actual</u>	<u>Variance with Final Budget</u>	<u>Budgeted Amounts</u>		<u>Actual</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>			<u>Original</u>	<u>Final</u>		
Revenues:								
Departmental:								
Federal funds.....	\$ 97,094	\$ 162,777	\$ 119,357	\$ (43,420)	\$ —	\$ —	\$ —	\$ —
Local funds.....	—	—	—	—	—	—	—	—
Inter-agency grants and allocations.....	—	—	—	—	—	—	—	—
Intra-governmental transactions.....	—	—	47	47	320	1,439	1,256	(183)
Sales and services.....	—	—	—	—	—	—	—	—
Sale, rental and lease of property.....	1	1	—	(1)	—	—	—	—
Fees, licenses and fines.....	—	—	—	—	—	—	—	—
Contributions, gifts and grants.....	—	—	—	—	—	—	—	—
Miscellaneous.....	—	—	—	—	430	849	864	15
Total revenues.....	97,095	162,778	119,404	(43,374)	750	2,288	2,120	(168)
Expenditures:								
Current:								
General government.....	—	—	—	—	—	—	—	—
Health and human services.....	—	—	—	—	—	—	—	—
Environment and natural resources.....	—	—	—	—	—	—	—	—
Economic development.....	97,095	162,778	119,383	43,395	750	6,482	435	6,047
Primary and secondary education.....	—	—	—	—	—	—	—	—
Public safety and corrections.....	—	—	—	—	—	—	—	—
Debt service.....	—	—	—	—	—	—	—	—
Principal retirement.....	—	—	—	—	—	—	—	—
Interest and fees.....	—	—	—	—	—	—	—	—
Total expenditures.....	97,095	162,778	119,383	43,395	750	6,482	435	6,047
Excess revenues over (under) expenditures	\$ —	\$ —	21	\$ 21	\$ —	\$ (4,194)	1,685	\$ 5,879
Unreserved fund balances (budgetary basis) at July 1, 2005.....			5				5,812	
Restatements.....			—				—	
Unreserved fund balances (budgetary basis) at June 30, 2006.....			\$ 26				\$ 7,497	

Exhibit C-5

Employment Security Commission Funds				Highway Patrol Fund			
<i>Budgeted Amounts</i>		<i>Actual</i>	<i>Variance with Final Budget</i>	<i>Budgeted Amounts</i>		<i>Actual</i>	<i>Variance with Final Budget</i>
<i>Original</i>	<i>Final</i>			<i>Original</i>	<i>Final</i>		
\$ 159,306	\$ 189,490	\$ 185,124	\$ (4,366)	\$ —	\$ 327	\$ 331	\$ 4
15,195	18,695	16,745	(1,950)	—	—	—	—
6,788	4,188	3,579	(609)	—	697	301	(396)
20,072	45,555	42,216	(3,339)	185,999	226,773	203,038	(23,735)
—	—	—	—	1,544	1,544	1,193	(351)
—	—	—	—	5,634	5,635	3,754	(1,881)
—	—	—	—	—	45	202	157
—	—	—	—	—	8	—	(8)
1,205	2,305	2,028	(277)	1	828	1,058	230
<u>202,566</u>	<u>260,233</u>	<u>249,692</u>	<u>(10,541)</u>	<u>193,178</u>	<u>235,857</u>	<u>209,877</u>	<u>(25,980)</u>
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
202,566	260,233	249,788	10,445	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	193,178	235,857	199,862	35,995
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
<u>202,566</u>	<u>260,233</u>	<u>249,788</u>	<u>10,445</u>	<u>193,178</u>	<u>235,857</u>	<u>199,862</u>	<u>35,995</u>
<u>\$ —</u>	<u>\$ —</u>	<u>(96)</u>	<u>\$ (96)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>10,015</u>	<u>\$ 10,015</u>
		1,460				4,918	
		—				—	
		<u>\$ 1,364</u>				<u>\$ 14,933</u>	

Continued

**COMBINING SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN UNRESERVED
FUND BALANCES — BUDGET AND ACTUAL (BUDGETARY BASIS — NON-GAAP)
NONMAJOR SPECIAL REVENUE FUNDS**

For the Fiscal Year Ended June 30, 2006

(Dollars in Thousands)

	Wildlife Resources Commission Fund				Education Lottery Funds			
	<u>Budgeted Amounts</u>		<u>Actual</u>	<u>Variance with Final Budget</u>	<u>Budgeted Amounts</u>		<u>Actual</u>	<u>Variance with Final Budget</u>
	<u>Original</u>	<u>Final</u>			<u>Original</u>	<u>Final</u>		
Revenues:								
Departmental:								
Federal funds.....	\$ 8,522	\$ 12,386	\$ 12,329	\$ (57)	\$ —	\$ —	\$ —	\$ —
Local funds.....	13	168	171	3	—	—	—	—
Inter-agency grants and allocations.....	266	33	21	(12)	—	—	—	—
Intra-governmental transactions.....	41,143	97,408	96,388	(1,020)	—	50,000	50,000	—
Sales and services.....	1,619	2,171	3,301	1,130	—	—	—	—
Sale, rental and lease of property.....	165	206	206	—	—	—	—	—
Fees, licenses and fines.....	18,056	19,649	19,651	2	—	—	—	—
Contributions, gifts and grants.....	85	247	211	(36)	—	—	—	—
Miscellaneous.....	12	331	349	18	—	—	—	—
Total revenues.....	<u>69,881</u>	<u>132,599</u>	<u>132,627</u>	<u>28</u>	<u>—</u>	<u>50,000</u>	<u>50,000</u>	<u>—</u>
Expenditures:								
Current:								
General government.....	—	—	—	—	—	—	—	—
Health and human services.....	—	—	—	—	—	—	—	—
Environment and natural resources.....	69,881	140,938	136,311	4,627	—	—	—	—
Economic development.....	—	—	—	—	—	—	—	—
Primary and secondary education.....	—	—	—	—	—	50,000	—	50,000
Public safety and corrections.....	—	—	—	—	—	—	—	—
Debt service.....	—	—	—	—	—	—	—	—
Principal retirement.....	—	650	650	—	—	—	—	—
Interest and fees.....	—	783	783	—	—	—	—	—
Total expenditures.....	<u>69,881</u>	<u>142,371</u>	<u>137,744</u>	<u>4,627</u>	<u>—</u>	<u>50,000</u>	<u>—</u>	<u>50,000</u>
Excess revenues over (under) expenditures.....	<u>\$ —</u>	<u>\$ (9,772)</u>	<u>(5,117)</u>	<u>\$ 4,655</u>	<u>\$ —</u>	<u>\$ —</u>	<u>50,000</u>	<u>\$ 50,000</u>
Unreserved fund balances (budgetary basis) at July 1, 2005.....			13,033				—	
Restatements.....			—				—	
Unreserved fund balances (budgetary basis) at June 30, 2006.....			<u>\$ 7,916</u>				<u>\$ 50,000</u>	

Exhibit C-5

Totals -

Departmental Funds				Budgeted Special Revenue Funds			
Budgeted Amounts		Actual	Variance with Final	Budgeted Amounts		Actual	Variance with Final
Original	Final		Budget	Original	Final		Budget
\$ 51,917	\$ 45,358	\$ 65,774	\$ 20,416	\$ 316,839	\$ 410,338	\$ 382,915	\$ (27,423)
110	580	9	(571)	15,318	19,443	16,925	(2,518)
1,973	5,251	1,494	(3,757)	9,027	10,169	5,395	(4,774)
152,327	208,668	136,725	(71,943)	399,861	629,843	529,670	(100,173)
4,549	8,958	6,795	(2,163)	7,712	12,673	11,289	(1,384)
89	87	102	15	5,889	5,929	4,062	(1,867)
83,422	95,589	91,423	(4,166)	101,478	115,283	111,276	(4,007)
414	2,234	1,924	(310)	499	2,489	2,135	(354)
2,393	3,175	4,710	1,535	4,041	7,488	9,009	1,521
<u>297,194</u>	<u>369,900</u>	<u>308,956</u>	<u>(60,944)</u>	<u>860,664</u>	<u>1,213,655</u>	<u>1,072,676</u>	<u>(140,979)</u>
75,407	205,473	137,340	68,133	75,407	205,473	137,340	68,133
105,562	91,258	66,472	24,786	105,562	91,258	66,472	24,786
52,032	61,604	43,217	18,387	121,913	202,542	179,528	23,014
32,594	82,979	42,717	40,262	333,005	512,472	412,323	100,149
—	—	—	—	—	50,000	—	50,000
31,341	42,247	39,001	3,246	224,519	278,104	238,863	39,241
—	—	—	—	—	650	650	—
—	—	—	—	—	783	783	—
<u>296,936</u>	<u>483,561</u>	<u>328,747</u>	<u>154,814</u>	<u>860,406</u>	<u>1,341,282</u>	<u>1,035,959</u>	<u>305,323</u>
<u>\$ 258</u>	<u>\$(113,661)</u>	<u>(19,791)</u>	<u>\$ 93,870</u>	<u>\$ 258</u>	<u>\$(127,627)</u>	<u>36,717</u>	<u>\$ 164,344</u>

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NONMAJOR CAPITAL PROJECTS FUNDS

The Capital Projects funds are maintained to account for those financial resources received and used for the acquisition, construction or improvement of major governmental general fixed assets which are financed principally by transfers from the General Fund or lease purchase revenue bonds and certificates of participation.

The following activities are included in the nonmajor capital projects funds:

Capital Projects Fund
N.C. Infrastructure Finance Corporation
State Energy Contracts

**COMBINING BALANCE SHEET
NONMAJOR CAPITAL PROJECTS FUNDS**

June 30, 2006

Exhibit C-6

(Dollars in Thousands)

	Capital Projects Fund	N.C. Infrastructure Finance Corporation	State Energy Contracts	Total Nonmajor Capital Projects Funds
Assets				
Cash and cash equivalents	\$ 238,550	\$ 2,054	\$ —	\$ 240,604
Investments.....	—	13,756	14,776	28,532
Securities lending collateral.....	886	—	—	886
Receivables, net:				
Intergovernmental receivable.....	353	—	—	353
Interest receivable.....	4	—	—	4
Due from other funds	—	8,386	—	8,386
Total Assets.....	\$ 239,793	\$ 24,196	\$ 14,776	\$ 278,765
Liabilities and Fund Balances				
Liabilities:				
Accounts payable and accrued liabilities:				
Accounts payable.....	\$ 10,657	\$ 13,447	\$ —	\$ 24,104
Intergovernmental payable.....	653	—	—	653
Obligations under securities lending transactions.....	886	—	—	886
Due to other funds	25	13	—	38
Deposits payable.....	1	—	—	1
Total Liabilities.....	12,222	13,460	—	25,682
Fund Balances:				
Reserved for:				
Capital projects.....	34,388	105,262	—	139,650
Unreserved:				
Undesignated.....	193,183	(94,526)	14,776	113,433
Total Fund Balances.....	227,571	10,736	14,776	253,083
Total Liabilities and Fund Balances.....	\$ 239,793	\$ 24,196	\$ 14,776	\$ 278,765

**COMBINING STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
NONMAJOR CAPITAL PROJECTS FUNDS**

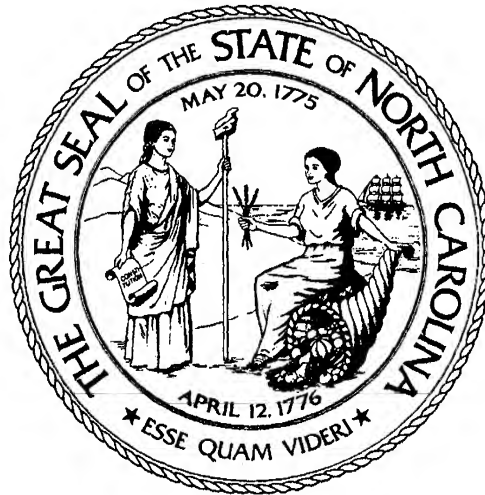
For the Fiscal Year Ended June 30, 2006

Exhibit C-7

(Dollars in Thousands)

	Capital Projects Fund	N.C. Infrastructure Finance Corporation	State Energy Contracts	Total Nonmajor Capital Projects Funds
Revenues:				
Federal funds.....	\$ 20,390	\$ —	\$ —	\$ 20,390
Investment earnings.....	73	911	518	1,502
Sales and services.....	1,057	—	—	1,057
Rental and lease of property.....	49	—	—	49
Contributions, gifts, and grants.....	73,858	—	—	73,858
Miscellaneous.....	362	—	—	362
Total revenues.....	95,789	911	518	97,218
Expenditures:				
Current:				
Higher education.....	33	—	—	33
Environment & natural resources.....	35	—	—	35
Capital outlay.....	152,675	108,643	9,564	270,882
Debt service:				
Interest and fees.....	—	126	9	135
Total expenditures.....	152,743	108,769	9,573	271,085
Excess revenues over (under) expenditures.....	(56,954)	(107,858)	(9,055)	(173,867)
Other Financing Sources (Uses):				
Other debt issued.....	—	—	23,831	23,831
Sale of capital assets.....	10	—	—	10
Transfers in.....	113,693	81,436	—	195,129
Transfers out.....	(610)	(924)	—	(1,534)
Total other financing sources (uses).....	113,093	80,512	23,831	217,436
Net change in fund balances.....	56,139	(27,346)	14,776	43,569
Fund balances — July 1	171,432	38,082	—	209,514
Fund balances — June 30.....	\$ 227,571	\$ 10,736	\$ 14,776	\$ 253,083

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NONMAJOR PERMANENT FUNDS

Permanent funds are used to report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government's programs—that is, for the benefit of the government or its citizenry.

The following are included in nonmajor permanent funds:

Wildlife Endowment Fund
Departmental Funds

**COMBINING BALANCE SHEET
NONMAJOR PERMANENT FUNDS**

June 30, 2006

Exhibit C-8

(Dollars in Thousands)

	Wildlife Endowment Fund	Departmental Funds	Total Nonmajor Permanent Funds
Assets			
Cash and cash equivalents	\$ 190	\$ 944	\$ 1,134
Receivables, net:			
Accounts receivable.....	12	—	12
Interest receivable.....	—	3	3
Securities lending collateral	32,163	810	32,973
Endowment investments.....	57,193	548	57,741
Total Assets.....	<u>\$ 89,558</u>	<u>\$ 2,305</u>	<u>\$ 91,863</u>
Liabilities and Fund Balances			
Liabilities:			
Obligations under securities lending.....	32,163	810	32,973
Total Liabilities.....	<u>32,163</u>	<u>810</u>	<u>32,973</u>
Fund Balances:			
Reserved for:			
Permanent investments.....	55,965	1,407	57,372
Unreserved:			
Undesignated.....	1,430	88	1,518
Total Fund Balances.....	<u>57,395</u>	<u>1,495</u>	<u>58,890</u>
Total Liabilities and Fund Balances.....	<u>\$ 89,558</u>	<u>\$ 2,305</u>	<u>\$ 91,863</u>

**COMBINING STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES
NONMAJOR PERMANENT FUNDS**

For the Fiscal Year Ended June 30, 2006

Exhibit C-9

(Dollars in Thousands)

	Wildlife Endowment Fund	Departmental Funds	Total Nonmajor Permanent Funds
Revenues:			
Investment earnings.....	\$ (224)	\$ 35	\$ (189)
Sales and services.....	69	—	69
Fees, licenses, and fines.....	4,569	—	4,569
Contributions, gifts, and grants.....	36	—	36
Total revenues.....	4,450	35	4,485
Expenditures:			
Current:			
Higher education.....	—	26	26
Health and human services.....	—	9	9
Environment and natural resources.....	1,426	8	1,434
Total expenditures.....	1,426	43	1,469
Excess revenues over (under) expenditures.....	3,024	(8)	3,016
Other Financing Sources (Uses):			
Transfers in.....	—	680	680
Transfers out.....	(3,356)	—	(3,356)
Total other financing sources (uses).....	(3,356)	680	(2,676)
Net change in fund balances.....	(332)	672	340
Fund balances — July 1.....	57,727	823	58,550
Fund balances — June 30.....	\$ 57,395	\$ 1,495	\$ 58,890

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PROPRIETARY FUNDS

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NONMAJOR ENTERPRISE FUNDS

Enterprise funds are used to report activities for which a fee is charged to external users for goods or services.

The following activities are included in the nonmajor enterprise funds:

- Public School Insurance
- Town of Butner Water and Sewer
- North Carolina State Fair
- USS North Carolina Battleship Commission
- Agricultural Farmers Market
- Workers' Compensation
- Utilities Commission
- State Banking Commission
- ABC Commission
- Departmental Funds

COMBINING STATEMENT OF NET ASSETS NONMAJOR ENTERPRISE FUNDS

June 30, 2006

(Dollars in Thousands)

	Public School Insurance	Town of Butner Water and Sewer	North Carolina State Fair	USS North Carolina Battleship Commission	Agricultural Farmers Market	Workers' Compensation
Assets						
Current Assets:						
Cash and cash equivalents.....	\$ 2,815	\$ 4,776	\$ 2,486	\$ 1,094	\$ 1,306	\$ 6,097
Investments.....	36,107	—	—	—	—	13,347
Securities lending collateral.....	22,620	4,095	—	—	—	12,649
Receivables:						
Accounts receivable, net.....	—	4	205	1	8	13
Interest receivable.....	9	—	—	—	—	18
Premiums receivable.....	1,257	—	—	—	—	—
Inventories.....	—	1	106	211	9	—
Prepaid items.....	2,141	—	—	72	—	—
Total current assets.....	<u>64,949</u>	<u>8,876</u>	<u>2,797</u>	<u>1,378</u>	<u>1,323</u>	<u>32,124</u>
Noncurrent Assets:						
Restricted/designated cash and cash equivalents.....	—	1,627	—	—	—	—
Investments.....	—	—	—	462	—	—
Restricted investments.....	—	—	—	3,269	—	—
Deferred charges.....	—	107	—	—	—	—
Capital assets-nondepreciable.....	—	1,795	1,379	629	1,087	—
Capital assets-depreciable, net.....	—	24,275	8,824	2,069	6,299	—
Total noncurrent assets.....	<u>—</u>	<u>27,804</u>	<u>10,203</u>	<u>6,429</u>	<u>7,386</u>	<u>—</u>
Total Assets.....	<u>64,949</u>	<u>36,680</u>	<u>13,000</u>	<u>7,807</u>	<u>8,709</u>	<u>32,124</u>
Liabilities						
Current Liabilities:						
Accounts payable and accrued liabilities:						
Accounts payable.....	10	66	85	25	16	36
Accrued payroll.....	2	—	60	17	10	—
Claims payable.....	796	—	—	—	—	11,173
Obligations under securities lending...	22,620	4,095	—	—	—	12,649
Interest payable.....	—	33	—	—	—	—
Due to other funds.....	1	—	11	—	1	—
Unearned revenue.....	3,189	—	725	2	—	1,383
Deposits payable.....	—	28	—	—	—	—
Notes payable.....	—	112	—	—	—	—
Bonds payable - current.....	—	280	—	—	—	—
Compensated absences - current.....	7	—	18	8	6	—
Total current liabilities.....	<u>26,625</u>	<u>4,614</u>	<u>899</u>	<u>52</u>	<u>33</u>	<u>25,241</u>
Noncurrent Liabilities:						
Notes payable.....	—	1,345	—	—	—	—
Bonds payable, net.....	—	8,520	—	—	—	—
Compensated absences.....	71	28	178	68	62	—
Total noncurrent liabilities.....	<u>71</u>	<u>9,893</u>	<u>178</u>	<u>68</u>	<u>62</u>	<u>—</u>
Total Liabilities.....	<u>26,696</u>	<u>14,507</u>	<u>1,077</u>	<u>120</u>	<u>95</u>	<u>25,241</u>
Net Assets						
Invested in capital assets, net of related debt.....	—	17,237	10,203	2,698	7,386	—
Restricted for:						
Capital outlay.....	—	—	—	2,629	—	—
Other purposes.....	—	—	—	1,102	—	—
Unrestricted.....	38,253	4,936	1,720	1,258	1,228	6,883
Total Net Assets.....	<u>\$ 38,253</u>	<u>\$ 22,173</u>	<u>\$ 11,923</u>	<u>\$ 7,687</u>	<u>\$ 8,614</u>	<u>\$ 6,883</u>

Exhibit D-1

<u>Utilities Commission</u>	<u>State Banking Commission</u>	<u>ABC Commission</u>	<u>Departmental Funds</u>	<u>Total Nonmajor Enterprise Funds</u>
\$ 9,827	\$ 6,813	\$ 5,652	\$ 1,746	\$ 42,612
—	—	—	—	49,454
8,252	—	—	—	47,616
4,874	352	1,681	2	7,140
—	—	—	—	27
—	—	—	—	1,257
38	—	88	48	501
—	—	—	—	2,213
<u>22,991</u>	<u>7,165</u>	<u>7,421</u>	<u>1,796</u>	<u>150,820</u>
—	—	—	—	1,627
—	—	—	—	462
—	—	—	—	3,269
—	—	—	—	107
—	—	550	—	5,440
94	76	3,087	2,130	46,854
94	76	3,637	2,130	57,759
<u>23,085</u>	<u>7,241</u>	<u>11,058</u>	<u>3,926</u>	<u>208,579</u>
46	185	348	25	842
2	—	5	11	107
—	—	—	—	11,969
8,252	—	—	—	47,616
—	—	—	—	33
9	10	12	1	45
—	1,555	—	147	7,001
—	—	—	—	28
—	—	—	—	112
—	—	—	—	280
64	36	11	6	156
<u>8,373</u>	<u>1,786</u>	<u>376</u>	<u>190</u>	<u>68,189</u>
—	—	—	—	1,345
—	—	—	—	8,520
1,288	741	217	53	2,706
<u>1,288</u>	<u>741</u>	<u>217</u>	<u>53</u>	<u>12,571</u>
<u>9,661</u>	<u>2,527</u>	<u>593</u>	<u>243</u>	<u>80,760</u>
94	76	3,637	2,130	43,461
—	—	—	—	2,629
—	—	—	—	1,102
13,330	4,638	6,828	1,553	80,627
<u>\$ 13,424</u>	<u>\$ 4,714</u>	<u>\$ 10,465</u>	<u>\$ 3,683</u>	<u>\$ 127,819</u>

COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS NONMAJOR ENTERPRISE FUNDS

For the Fiscal Year Ended June 30, 2006

(Dollars in Thousands)

	Public School Insurance	Town of Butner Water and Sewer	North Carolina State Fair	USS North Carolina Battleship Commission	Agricultural Farmers Market	Workers' Compensation
Operating Revenues:						
Sales and services.....	\$ —	\$ —	\$ 138	\$ 665	\$ 22	\$ —
Sales and services used as security for bonds, net.....	—	2,377	—	—	—	—
Rental and lease earnings.....	—	5	4,218	—	530	—
Fees, licenses and fines.....	—	8	8,225	1,420	753	—
Insurance premiums.....	12,108	—	—	—	—	2,752
Miscellaneous.....	—	10	—	101	—	—
Total operating revenues.....	12,108	2,400	12,581	2,186	1,305	2,752
Operating Expenses:						
Personal services.....	539	1,032	3,939	964	755	—
Supplies and materials.....	2	248	780	96	75	—
Services.....	61	400	4,154	738	310	693
Cost of goods sold.....	—	—	—	299	—	—
Depreciation/amortization.....	—	1,662	618	128	292	—
Claims.....	3,096	—	—	—	—	6,715
Insurance and bonding.....	2,489	2	145	18	40	955
Other.....	1	579	861	70	32	—
Total operating expenses.....	6,188	3,923	10,497	2,313	1,504	8,363
Operating income (loss).....	5,920	(1,523)	2,084	(127)	(199)	(5,611)
Nonoperating Revenues (Expenses):						
Noncapital grants.....	—	—	—	—	—	—
Noncapital gifts.....	—	—	100	—	—	—
Investment earnings (loss).....	430	312	—	274	—	422
Interest and fees.....	—	(433)	—	—	—	—
Insurance recoveries.....	—	28	—	—	361	—
Gain (loss) on sale of equipment.....	—	4	—	—	—	—
Miscellaneous.....	(960)	(164)	9	—	2	(540)
Total nonoperating revenues (expenses).....	(530)	(253)	109	274	363	(118)
Income (loss) before contributions and transfers.....	5,390	(1,776)	2,193	147	164	(5,729)
Capital contributions.....	—	—	—	40	218	—
Transfers in.....	—	—	136	—	—	2,000
Transfers out.....	—	(238)	(4,495)	—	(350)	—
Change in net assets.....	5,390	(2,014)	(2,166)	187	32	(3,729)
Net assets — July 1, as restated.....	32,863	24,187	14,089	7,500	8,582	10,612
Net assets — June 30.....	\$ 38,253	\$ 22,173	\$ 11,923	\$ 7,687	\$ 8,614	\$ 6,883

Exhibit D-2

Utilities Commission	State Banking Commission	ABC Commission	Departmental Funds	Total Nonmajor Enterprise Funds
\$ 10	\$ —	\$ 3	\$ 155	\$ 993
—	—	—	—	2,377
—	—	—	784	5,537
16,192	9,923	7,350	1,143	45,014
—	—	—	—	14,860
24	17	31	—	183
16,226	9,940	7,384	2,082	68,964
10,845	5,736	2,133	782	26,725
36	43	43	207	1,530
530	2,206	4,379	542	14,013
—	—	—	125	424
67	8	117	91	2,983
—	—	—	—	9,811
2	1	14	39	3,705
1,068	778	197	132	3,718
12,548	8,772	6,883	1,918	62,909
3,678	1,168	501	164	6,055
222	—	—	—	222
—	—	—	63	163
628	—	—	—	2,066
—	—	—	—	(433)
—	—	—	—	389
—	—	—	—	4
(323)	—	—	2	(1,974)
527	—	—	65	437
4,205	1,188	501	229	6,492
—	—	—	—	258
—	—	—	19	2,155
(314)	(150)	(110)	—	(5,657)
3,891	1,018	391	248	3,248
9,533	3,696	10,074	3,435	124,571
\$ 13,424	\$ 4,714	\$ 10,465	\$ 3,683	\$ 127,819

For the Fiscal Year Ended June 30, 2006

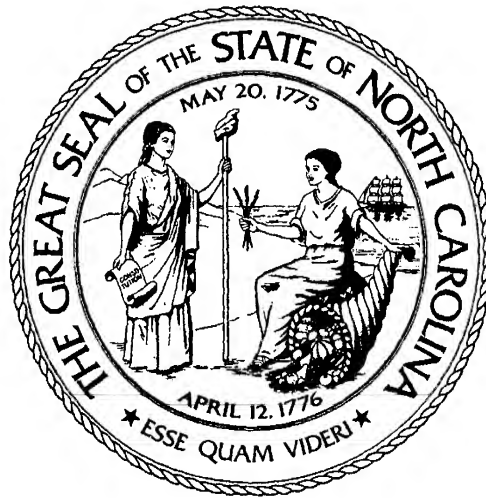
(Dollars in Thousands)

	Public School Insurance	Town of Butner Water and Sewer	North Carolina State Fair	USS North Carolina Battleship Commission	Agricultural Farmers Market	Workers' Compensation
Cash Flows from Operating Activities:						
Receipts from customers.....	\$ 12,641	\$ 2,077	\$ 12,508	\$ 2,188	\$ 1,311	\$ 2,301
Receipts from other funds.....	—	378	—	—	—	—
Payments to suppliers.....	(3,050)	(528)	(6,035)	(1,194)	(457)	(1,595)
Payments to employees.....	(527)	(1,139)	(3,877)	(937)	(741)	—
Payments for prizes, benefits and claims.....	(3,530)	—	—	—	—	(5,656)
Payments to other funds.....	—	(226)	—	—	—	—
Other receipts (payments).....	(1)	(287)	9	—	2	—
Net cash flows provided (used) by operating activities.....	5,533	275	2,605	57	115	(4,950)
Cash Provided From (Used For)						
Noncapital Financing Activities:						
Grant receipts (refunds).....	—	—	—	—	—	—
Transfers from other funds.....	—	—	87	—	—	2,000
Transfers to other funds.....	—	(238)	(4,495)	—	(350)	—
Gifts.....	—	—	100	—	—	—
Total cash provided from (used for) noncapital financing activities.....	—	(238)	(4,308)	—	(350)	2,000
Cash Provided From (Used For)						
Capital Financing Activities:						
Acquisition and construction of capital assets.....	—	(482)	(123)	—	(15)	—
Proceeds from the sale of capital assets.....	—	4	—	—	—	—
Capital contributions.....	—	—	—	40	—	—
Principal paid on capital debt.....	—	(270)	—	—	—	—
Interest paid on capital debt.....	—	(364)	—	—	—	—
Payment to bond escrow agent.....	—	(46)	—	—	—	—
Insurance recoveries.....	—	28	—	—	361	—
Total cash provided from (used for) capital financing activities.....	—	(1,130)	(123)	40	346	—
Cash Provided From (Used For)						
Investment Activities:						
Purchase of non-State Treasurer investments.....	—	—	—	(179)	—	—
Purchase into State Treasurer investment pool.....	(12,000)	—	—	—	—	—
Investment earnings (loss).....	278	158	—	202	—	242
Total cash provided from (used for) investment activities.....	(11,722)	158	—	23	—	242
Net increase (decrease) in cash and cash equivalents	(6,189)	(935)	(1,826)	120	111	(2,708)
Cash and cash equivalents at July 1.....	9,004	7,338	4,312	974	1,195	8,805
Cash and cash equivalents at June 30.....	\$ 2,815	\$ 6,403	\$ 2,486	\$ 1,094	\$ 1,306	\$ 6,097
Reconciliation of Operating Income to Net Cash Provided						
From (Used For) Operating Activities:						
Operating income (loss).....	\$ 5,920	\$ (1,523)	\$ 2,084	\$ (127)	\$ (199)	\$ (5,611)
Adjustments to reconcile operating income to net cash flows from operating activities:						
Depreciation/amortization.....	—	1,662	618	128	292	—
Restatements and adjustments to cash.....	—	—	—	—	—	45
Nonoperating miscellaneous income (expense)...	—	—	9	—	2	—
(Increases) decreases in assets:						
Receivables.....	301	117	(182)	2	7	2
Due from other funds.....	—	—	—	—	—	—
Inventories.....	—	160	(32)	17	(2)	—
Prepaid items.....	(495)	—	—	12	—	—
Increases (decreases) in liabilities:						
Accounts payable and accrued liabilities.....	(436)	18	(47)	—	6	1,067
Due to other funds.....	(1)	(1)	7	—	(1)	—
Compensated absences.....	12	(107)	40	25	10	—
Unearned revenue.....	232	(2)	108	—	—	(453)
Deposits payable.....	—	(49)	—	—	—	—
Total cash provided from (used for) operations.....	\$ 5,533	\$ 275	\$ 2,605	\$ 57	\$ 115	\$ (4,950)
Noncash Investing, Capital, and Financing Activities:						
Noncash distributions from the State Treasurer						
Long-Term Investment Portfolio and/or other agents \$	1,632	\$ —	\$ —	\$ —	\$ —	\$ 729
Donated assets (fair market value).....	—	—	—	—	218	—
Transferred assets.....	—	—	49	—	—	—
Assets acquired through the assumption of a liability.	22,620	4,095	—	—	—	12,649
Change in fair value of investments.....	(2,429)	—	—	250	—	(1,091)

Exhibit D-3

Utilities Commission	State Banking Commission	ABC Commission	Departmental Funds	Total Nonmajor Enterprise Funds
\$ 13,504	\$ 9,761	\$ 7,282	\$ 2,111	\$ 65,684
—	—	—	1	379
(1,034)	(2,392)	(4,645)	(1,042)	(21,972)
(10,465)	(5,463)	(2,078)	(766)	(25,993)
—	—	—	—	(9,186)
—	—	—	—	(226)
(603)	(503)	10	2	(1,371)
1,402	1,403	569	306	7,315
222	—	—	—	222
—	—	—	—	2,087
(314)	(150)	(110)	—	(5,657)
—	—	—	63	163
(92)	(150)	(110)	63	(3,185)
(26)	(8)	(98)	—	(752)
122	4	19	—	149
—	—	—	—	40
—	—	—	—	(270)
—	—	—	—	(364)
—	—	—	—	(46)
—	—	—	—	389
96	(4)	(79)	—	(854)
—	—	—	—	(179)
—	—	—	—	(12,000)
305	—	—	—	1,185
305	—	—	—	(10,994)
1,711	1,249	380	369	(7,718)
8,116	5,564	5,272	1,377	51,957
\$ 9,827	\$ 6,813	\$ 5,652	\$ 1,746	\$ 44,239
\$ 3,678	\$ 1,168	\$ 501	\$ 164	\$ 6,055
67	8	117	91	2,983
—	—	—	—	45
—	—	—	2	13
(2,696)	(339)	(72)	7	(2,853)
—	—	—	1	1
—	—	(70)	1	74
—	—	—	—	(483)
(24)	111	36	10	741
(2)	5	3	—	10
379	273	54	7	693
—	177	—	23	85
—	—	—	—	(49)
\$ 1,402	\$ 1,403	\$ 569	\$ 306	\$ 7,315
\$ —	\$ —	\$ —	\$ —	\$ 2,361
—	—	—	—	218
—	—	—	19	68
8,252	—	—	—	47,616
—	—	—	—	(3,270)

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INTERNAL SERVICE FUNDS

The internal service funds are maintained to account for the operations of State agencies that provide services to other State agencies, component units, or other governmental units on a cost reimbursement basis.

The following activities are included in the internal service funds:

Office of the State Controller:

Workers' Compensation Program

Department of Administration:

Motor Fleet Management
Mail Service Center
Temporary Solutions
Surplus Property

Office of the Governor:

Computing Services
State Telecommunications Services

Department of Insurance:

State Property Fire Insurance

COMBINING STATEMENT OF NET ASSETS INTERNAL SERVICE FUNDS

June 30, 2006

(Dollars in Thousands)

	Workers' Compensation Program	State Property Fire Insurance	Motor Fleet Management	Mail Service Center	Temporary Solutions
Assets					
Current Assets:					
Cash and cash equivalents.....	\$ 846	\$ 31,954	\$ 5,506	\$ —	\$ 1,515
Investments.....	—	20,916	—	—	—
Securities lending collateral.....	—	39,109	—	—	—
Receivables:					
Accounts receivable, net.....	1,838	—	1,558	804	1,123
Interest receivable.....	—	97	—	—	—
Premiums receivable.....	—	261	—	—	—
Due from fiduciary funds.....	—	—	—	—	—
Due from other funds.....	1,425	—	4,034	—	18
Due from component units.....	—	—	546	—	—
Inventories.....	—	—	182	115	—
Prepaid items.....	—	—	—	—	—
Total current assets.....	4,109	92,337	11,826	919	2,656
Noncurrent Assets:					
Capital assets-nondepreciable.....	—	—	418	—	—
Capital assets-depreciable, net.....	—	—	68,617	304	—
Total noncurrent assets.....	—	—	69,035	304	—
Total Assets.....	4,109	92,337	80,861	1,223	2,656
Liabilities					
Current Liabilities:					
Accounts payable and accrued liabilities:					
Accounts payable.....	—	—	2,229	25	3
Accrued payroll.....	—	—	14	44	313
Intergovernmental payable.....	—	—	—	—	—
Claims payable.....	—	1,060	—	—	—
Obligations under securities lending.....	—	39,109	—	—	—
Due to other funds.....	—	—	42	954	2
Unearned revenue.....	—	6,778	—	—	—
Compensated absences - current.....	—	26	13	15	3
Total current liabilities.....	—	46,973	2,298	1,038	321
Noncurrent Liabilities:					
Compensated absences.....	—	275	147	154	19
Total noncurrent liabilities.....	—	275	147	154	19
Total Liabilities.....	—	47,248	2,445	1,192	340
Net Assets					
Invested in capital assets, net of related debt.....	—	—	69,035	304	—
Unrestricted.....	4,109	45,089	9,381	(273)	2,316
Total Net Assets.....	\$ 4,109	\$ 45,089	\$ 78,416	\$ 31	\$ 2,316

Exhibit E-1

Computing Services	State Telecommu- nications Services	Surplus Property	Totals
\$ 12,378	\$ 10,121	\$ 1,480	\$ 63,800
—	—	—	20,916
—	—	—	39,109
162	4,242	47	9,774
—	—	—	97
—	—	—	261
—	28	—	28
5,255	4,058	909	15,699
1	533	—	1,080
18	—	—	315
10,667	2,781	—	13,448
28,481	21,763	2,436	164,527
3,672	—	19	4,109
20,230	2,391	85	91,627
23,902	2,391	104	95,736
52,383	24,154	2,540	260,263
387	17	1,207	3,868
46	12	—	429
—	116	—	116
—	—	—	1,060
—	—	—	39,109
35	94	97	1,224
—	—	—	6,778
176	82	11	326
644	321	1,315	52,910
1,928	897	115	3,535
1,928	897	115	3,535
2,572	1,218	1,430	56,445
23,902	2,391	104	95,736
25,909	20,545	1,006	108,082
\$ 49,811	\$ 22,936	\$ 1,110	\$ 203,818

**COMBINING STATEMENT OF REVENUES, EXPENSES
AND CHANGES IN FUND NET ASSETS
INTERNAL SERVICE FUNDS**

For the Fiscal Year Ended June 30, 2006

(Dollars in Thousands)

	Workers' Compensation Program	State Property Fire Insurance	Motor Fleet Management	Mail Service Center	Temporary Solutions
Operating Revenues:					
Sales and services.....	\$ 43,772	\$ —	\$ 39,818	\$ 3,511	\$ 8,534
Rental and lease earnings.....	—	—	—	—	—
Fees, licenses and fines.....	—	—	—	—	—
Insurance premiums.....	—	18,666	—	—	—
Miscellaneous.....	—	—	55	—	1
Total operating revenues.....	<u>43,772</u>	<u>18,666</u>	<u>39,873</u>	<u>3,511</u>	<u>8,535</u>
Operating Expenses:					
Personal services.....	—	1,773	2,063	2,924	8,117
Supplies and materials.....	—	4	13,904	91	19
Services.....	43,881	158	2,445	749	47
Cost of goods sold.....	—	—	506	—	—
Depreciation/amortization.....	—	—	17,667	78	—
Claims.....	—	1,242	—	—	—
Insurance and bonding.....	—	7,417	2,265	—	—
Other.....	—	76	38	95	27
Total operating expenses.....	<u>43,881</u>	<u>10,670</u>	<u>38,888</u>	<u>3,937</u>	<u>8,210</u>
Operating income (loss).....	<u>(109)</u>	<u>7,996</u>	<u>985</u>	<u>(426)</u>	<u>325</u>
Nonoperating Revenues (Expenses):					
Investment earnings.....	—	1,838	—	—	—
Insurance recoveries.....	—	—	128	—	—
Gain (loss) on sale of equipment.....	—	—	(950)	—	—
Miscellaneous.....	—	(1,438)	2	—	—
Total nonoperating revenues (expenses).....	<u>—</u>	<u>400</u>	<u>(820)</u>	<u>—</u>	<u>—</u>
Income (loss) before contributions.....					
and transfers.....	(109)	8,396	165	(426)	325
Transfers in.....	—	—	1,020	336	—
Transfers out.....	—	(2)	(124)	(4)	—
Change in net assets.....	<u>(109)</u>	<u>8,394</u>	<u>1,061</u>	<u>(94)</u>	<u>325</u>
Net assets — July 1, as restated.....	4,218	36,695	77,355	125	1,991
Net assets — June 30.....	<u>\$ 4,109</u>	<u>\$ 45,089</u>	<u>\$ 78,416</u>	<u>\$ 31</u>	<u>\$ 2,316</u>

Exhibit E-2

Computing Services	State Telecommu- nications Services	Surplus Property	Totals
\$ 58,611	\$ 72,841	\$ 1,487	\$ 228,574
—	—	8	8
—	—	38	38
—	—	—	18,666
—	132	381	569
<u>58,611</u>	<u>72,973</u>	<u>1,914</u>	<u>247,855</u>
17,727	11,196	1,455	45,255
269	81	79	14,447
6,376	50,907	610	105,173
—	—	5	511
7,011	2,204	26	26,986
—	—	—	1,242
103	46	19	9,850
26,106	11,557	79	37,978
<u>57,592</u>	<u>75,991</u>	<u>2,273</u>	<u>241,442</u>
<u>1,019</u>	<u>(3,018)</u>	<u>(359)</u>	<u>6,413</u>
—	—	—	1,838
4	—	—	132
—	—	(2)	(952)
4	—	—	(1,432)
<u>8</u>	<u>—</u>	<u>(2)</u>	<u>(414)</u>
1,027	(3,018)	(361)	5,999
1,072	73	—	2,501
(16)	(10)	(4)	(160)
<u>2,083</u>	<u>(2,955)</u>	<u>(365)</u>	<u>8,340</u>
47,728	25,891	1,475	195,478
<u>\$ 49,811</u>	<u>\$ 22,936</u>	<u>\$ 1,110</u>	<u>\$ 203,818</u>

COMBINING STATEMENT OF CASH FLOWS **INTERNAL SERVICE FUNDS**

For the Fiscal Year Ended June 30, 2006

(Dollars in Thousands)

	Workers' Compensation Program	State Property Fire Insurance	Motor Fleet Management	Mail Service Center	Temporary Solutions
Cash Flows From Operating Activities:					
Receipts from customers.....	\$ 8,674	\$ 6,918	\$ 5,789	\$ 952	\$ —
Receipts from other funds.....	34,697	15,270	35,556	2,449	8,310
Payments to suppliers.....	(43,881)	(7,655)	(15,270)	(369)	(27)
Payments to employees.....	—	(1,696)	(2,037)	(2,897)	(8,251)
Payments for benefits and claims.....	—	(1,169)	—	—	—
Payments to other funds.....	—	(694)	(5,090)	(441)	(46)
Other receipts (payments).....	—	—	20	(26)	(27)
Net cash flows provided (used) by operating activities.....	(510)	10,974	18,968	(332)	(41)
Cash Provided From (Used For)					
Noncapital Financing Activities:					
Transfers from other funds.....	—	—	1,020	336	—
Transfers to other funds.....	—	(2)	(124)	(4)	—
Total cash provided from (used for) noncapital financing activities.....	—	(2)	896	332	—
Cash Provided From (Used For)					
Capital Financing Activities:					
Acquisition and construction of capital assets.....	—	—	(25,965)	—	—
Proceeds from the sale of capital assets.....	—	—	2,130	—	—
Insurance recoveries.....	—	—	128	—	—
Total cash provided from (used for) capital financing activities.....	—	—	(23,707)	—	—
Cash Provided From (Used For)					
Investment Activities:					
Investment earnings.....	—	916	—	—	—
Total cash provided from (used for) investment activities.....	—	916	—	—	—
Net increase (decrease) in cash and cash equivalents.....	(510)	11,888	(3,843)	—	(41)
Cash and cash equivalents at July 1.....	1,356	20,066	9,349	—	1,556
Cash and cash equivalents at June 30.....	\$ 846	\$ 31,954	\$ 5,506	\$ —	\$ 1,515
Reconciliation of Operating Income to Net Cash Provided					
From (Used For) Operating Activities:					
Operating income (loss).....	\$ (109)	\$ 7,996	\$ 985	\$ (426)	\$ 325
Adjustments to reconcile operating income to net cash flows from operating activities:					
Depreciation/amortization.....	—	—	17,667	78	—
Restatements and adjustments to cash.....	—	—	—	—	—
Nonoperating miscellaneous income (expense).....	—	—	2	—	—
(Increases) decreases in assets:					
Receivables.....	1,024	(135)	788	(110)	(209)
Due from other funds.....	(1,425)	—	571	—	(15)
Due from fiduciary funds.....	—	—	—	—	—
Due from component units.....	—	—	170	—	—
Inventories.....	—	—	(6)	(101)	—
Prepaid items.....	—	—	—	—	—
Increases (decreases) in liabilities:					
Accounts payable and accrued liabilities.....	—	(621)	(1,270)	10	(151)
Due to other funds.....	—	—	39	198	1
Compensated absences.....	—	77	22	19	8
Unearned revenue.....	—	3,657	—	—	—
Total cash provided from (used for) operations.....	\$ (510)	\$ 10,974	\$ 18,968	\$ (332)	\$ (41)
Noncash Investing, Capital, and Financing Activities:					
Noncash distributions from the State Treasurer					
Long-Term Investment Portfolio and/or other agents.....	\$ —	\$ (1,143)	\$ —	\$ —	\$ —
Assets acquired through the assumption of a liability.....	—	39,109	—	—	—
Change in fair value of investments.....	—	(1,710)	—	—	—

Exhibit E-3

Computing Services	State Telecommu- nications Services	Surplus Property	Totals
\$ 1,226	\$ 25,895	\$ 357	\$ 49,811
59,955	51,117	954	208,308
(38,539)	(62,719)	(172)	(166,632)
(17,565)	(11,133)	(1,433)	(45,012)
—	—	—	(1,169)
(2,998)	(1,143)	(745)	(11,157)
(111)	(24)	301	133
<u>3,968</u>	<u>1,993</u>	<u>(738)</u>	<u>34,282</u>

1,072	73	—	2,501
(16)	(10)	(4)	(160)
<u>1,056</u>	<u>63</u>	<u>(4)</u>	<u>2,341</u>

(5,917)	(875)	(6)	(32,763)
40	2	1	2,173
4	—	—	132
<u>(5,873)</u>	<u>(873)</u>	<u>(5)</u>	<u>(30,458)</u>

—	—	—	916
—	—	—	916
(849)	1,183	(747)	7,081
13,227	8,938	2,227	56,719
<u>\$ 12,378</u>	<u>\$ 10,121</u>	<u>\$ 1,480</u>	<u>\$ 63,800</u>

\$ 1,019	\$ (3,018)	\$ (359)	\$ 6,413
7,011	2,204	26	26,986
(609)	(2,758)	—	(3,367)
—	—	—	2
2,535	3,462	(28)	7,327
4	882	(196)	(179)
1	(25)	—	(24)
30	(148)	—	52
(18)	—	—	(125)
432	1,312	—	1,744
(6,296)	(76)	14	(8,390)
(406)	41	(219)	(346)
265	117	24	532
—	—	—	3,657
<u>\$ 3,968</u>	<u>\$ 1,993</u>	<u>\$ (738)</u>	<u>\$ 34,282</u>

\$ —	\$ —	\$ —	\$ (1,143)
—	—	—	39,109
—	—	—	(1,710)

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FIDUCIARY FUNDS

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PRIVATE PURPOSE TRUST FUNDS

Private purpose trust funds account for resources held in trust in which the principal and income benefit individuals, private organizations, or other governments.

The following activities are included in the private purpose trust funds:

Deposits of Insurance Carriers Fund
Administrative Office of the Courts Trust Fund
Departmental Funds

**COMBINING STATEMENT OF FIDUCIARY NET ASSETS
PRIVATE PURPOSE TRUST FUNDS**

June 30, 2006

Exhibit F-1

(Dollars in Thousands)

	Deposits of Insurance Carriers Fund	Administrative Office of the Courts Trust Fund	Departmental Funds	Totals
Assets				
Cash and cash equivalents.....	\$ 429	\$ 96,926	\$ 359	\$ 97,714
Investments:				
U.S. Government securities.....	—	1,564	—	1,564
State and municipal securities.....	—	99	—	99
Certificates of deposit.....	—	65,497	—	65,497
Securities lending collateral.....	368	—	308	676
Receivables:				
Interest receivable.....	1	—	1	2
Sureties.....	988,443	—	—	988,443
Total Assets.....	989,241	164,086	668	1,153,995
Liabilities				
Obligations under securities lending.....	368	—	308	676
Total Liabilities.....	368	—	308	676
Net Assets				
Held in trust for:				
Individuals, organizations and other governments.....	988,873	164,086	360	1,153,319
Total Net Assets.....	\$ 988,873	\$ 164,086	\$ 360	\$ 1,153,319

COMBINING STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS PRIVATE PURPOSE TRUST FUNDS

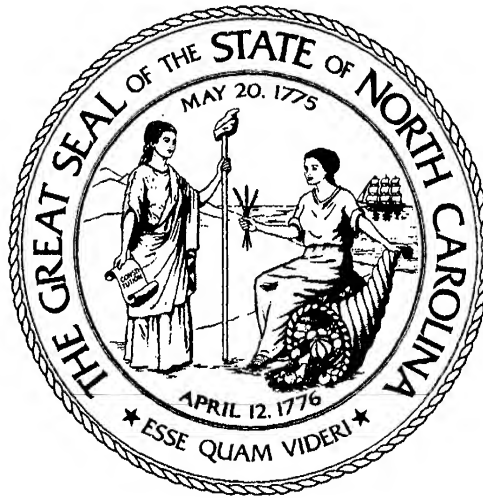
For the Fiscal Year Ended June 30, 2006

Exhibit F-2

(Dollars in Thousands)

	Deposits of Insurance Carriers Fund	Administrative Office of the Courts Trust Fund	Departmental Funds	Totals
Additions:				
Contributions:				
Trustee deposits.....	\$ 31,127	\$ 106,595	\$ 2	\$ 137,724
Total contributions.....	31,127	106,595	2	137,724
Investment Income:				
Investment earnings.....	28	3,158	24	3,210
Less investment expenses.....	(14)	—	(12)	(26)
Net investment income.....	14	3,158	12	3,184
Total additions.....	31,141	109,753	14	140,908
Deductions:				
Payments in accordance with trust arrangements.....	8,696	106,149	—	114,845
Administrative expenses.....	6	—	—	6
Total deductions.....	8,702	106,149	—	114,851
Change in net assets.....	22,439	3,604	14	26,057
Net assets — July 1.....	966,434	160,482	346	1,127,262
Net assets — June 30.....	<u>\$ 988,873</u>	<u>\$ 164,086</u>	<u>\$ 360</u>	<u>\$ 1,153,319</u>

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AGENCY FUNDS

Agency funds account for resources held by the State in a purely custodial capacity for individuals, private organizations, or other governments.

The following activities are included in the agency funds:

- Local Sales Tax Collections
- Clerks of Court
- Intra-Entity Investment Fund Deposits
- Insurers in Receivership
- Other Agency Funds

COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES**AGENCY FUNDS**

For the Fiscal Year Ended June 30, 2006

(Dollars in Thousands)

	Balance, July 1, 2005	Additions	Deductions	Balance, June 30, 2006
Local Sales Tax Collections				
Assets				
Cash and cash equivalents.....	\$ 391,745	\$ 2,912,601	\$ (2,890,697)	\$ 413,649
Receivables:				
Taxes receivable.....	168,400	31,600	—	200,000
Due from other funds.....	10,447	2,377	—	12,824
Total Assets.....	<u>\$ 570,592</u>	<u>\$ 2,946,578</u>	<u>\$ (2,890,697)</u>	<u>\$ 626,473</u>
Liabilities				
Accounts payable and accrued liabilities:				
Intergovernmental payables.....	\$ 570,592	\$ 2,734,707	\$ (2,678,826)	\$ 626,473
Total Liabilities.....	<u>\$ 570,592</u>	<u>\$ 2,734,707</u>	<u>\$ (2,678,826)</u>	<u>\$ 626,473</u>
Clerks of Court				
Assets				
Cash and cash equivalents.....	\$ 85,736	\$ 1,367,263	\$ (1,359,343)	\$ 93,656
Receivables:				
Accounts receivable.....	489	4,737	(4,755)	471
Sureties.....	82,506	48,481	(44,086)	86,901
Total Assets.....	<u>\$ 168,731</u>	<u>\$ 1,420,481</u>	<u>\$ (1,408,184)</u>	<u>\$ 181,028</u>
Liabilities				
Accounts payable and accrued liabilities:				
Intergovernmental payables.....	\$ 5,679	\$ 123,024	\$ (122,091)	\$ 6,612
Funds held for others.....	163,052	502,753	(491,389)	174,416
Total Liabilities.....	<u>\$ 168,731</u>	<u>\$ 625,777</u>	<u>\$ (613,480)</u>	<u>\$ 181,028</u>
Intra-Entity Investment Fund Deposits				
Assets				
Cash and cash equivalents.....	\$ 2,377,571	\$ —	\$ (388,184)	\$ 1,989,387
Investments:				
State Treasurer investment pool.....	46,274	—	(7,797)	38,477
Securities lending collateral.....	1,879,216	—	(156,685)	1,722,531
Receivables:				
Total Assets.....	<u>\$ 4,303,061</u>	<u>\$ —</u>	<u>\$ (552,666)</u>	<u>\$ 3,750,395</u>
Liabilities				
Obligations under securities lending.....	\$ 1,879,216	\$ —	\$ (156,685)	\$ 1,722,531
Funds held for others.....	2,423,845	—	(395,981)	2,027,864
Total Liabilities.....	<u>\$ 4,303,061</u>	<u>\$ —</u>	<u>\$ (552,666)</u>	<u>\$ 3,750,395</u>
Insurers in Receivership				
Assets				
Cash and cash equivalents.....	\$ 23,387	\$ —	\$ (1,220)	\$ 22,167
Investments:				
Corporate bonds.....	37,581	13,246	—	50,827
Corporate stocks.....	1,008	—	—	1,008
Certificates of deposit.....	12	—	(12)	—
Receivables:				
Accounts receivable.....	15,525	—	(12,895)	2,630
Interest receivable.....	156	131	—	287
Total Assets.....	<u>\$ 77,669</u>	<u>\$ 13,377</u>	<u>\$ (14,127)</u>	<u>\$ 76,919</u>
Liabilities				
Funds held for others.....	\$ 77,669	\$ 13,377	\$ (14,127)	\$ 76,919
Total Liabilities.....	<u>\$ 77,669</u>	<u>\$ 13,377</u>	<u>\$ (14,127)</u>	<u>\$ 76,919</u>

COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES**AGENCY FUNDS**

For the Fiscal Year Ended June 30, 2006

Exhibit F-3

(Dollars in Thousands)

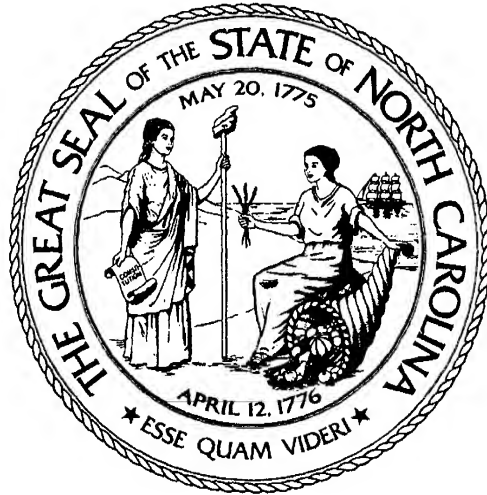
	Balance, July 1, 2005	Additions	Deductions	Balance, June 30, 2006
Other Agency Funds				
Assets				
Cash and cash equivalents.....	\$ 21,651	\$ 1,916,236	\$ (1,913,700)	\$ 24,187
Investments:				
Certificates of deposit.....	467	—	—	467
Securities lending collateral.....	12,713	1,968	—	14,681
Receivables:				
Accounts receivable.....	11	112	—	123
Interest receivable.....	1	—	—	1
Due from other funds.....	47	—	—	47
Inventories.....	301	—	—	301
Total Assets.....	<u>\$ 35,191</u>	<u>\$ 1,918,316</u>	<u>\$ (1,913,700)</u>	<u>\$ 39,807</u>
Liabilities				
Accounts payable and accrued liabilities:				
Accounts payable.....	\$ 486	\$ 7,953	\$ (7,498)	\$ 941
Intergovernmental payables.....	6,148	144,309	(144,309)	6,148
Obligations under securities lending.....	12,713	1,968	—	14,681
Deposits payable.....	1,590	3,857	(3,765)	1,682
Funds held for others.....	14,254	96,704	(94,603)	16,355
Total Liabilities.....	<u>\$ 35,191</u>	<u>\$ 254,791</u>	<u>\$ (250,175)</u>	<u>\$ 39,807</u>
Total Agency Funds				
Assets				
Cash and cash equivalents.....	\$ 2,900,090	\$ 6,196,100	\$ (6,553,144)	\$ 2,543,046
Investments:				
Corporate bonds.....	37,581	13,246	—	50,827
Corporate stocks.....	1,008	—	—	1,008
Certificates of deposit.....	479	—	(12)	467
State Treasurer investment pool.....	46,274	—	(7,797)	38,477
Securities lending collateral.....	1,891,929	1,968	(156,685)	1,737,212
Receivables:				
Taxes receivable.....	168,400	31,600	—	200,000
Accounts receivable.....	16,025	4,849	(17,650)	3,224
Interest receivable.....	157	131	—	288
Due from other funds.....	10,494	2,377	—	12,871
Inventories.....	301	—	—	301
Sureties.....	82,506	48,481	(44,086)	86,901
Total Assets.....	<u>\$ 5,155,244</u>	<u>\$ 6,298,752</u>	<u>\$ (6,779,374)</u>	<u>\$ 4,674,622</u>
Liabilities				
Accounts payable and accrued liabilities:				
Accounts payable.....	\$ 486	\$ 7,953	\$ (7,498)	\$ 941
Intergovernmental payables.....	582,419	3,002,040	(2,945,226)	639,233
Obligations under securities lending.....	1,891,929	1,968	(156,685)	1,737,212
Deposits payable.....	1,590	3,857	(3,765)	1,682
Funds held for others.....	2,678,820	612,834	(996,100)	2,295,554
Total Liabilities.....	<u>\$ 5,155,244</u>	<u>\$ 3,628,652</u>	<u>\$ (4,109,274)</u>	<u>\$ 4,674,622</u>

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COMPONENT UNITS

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NONMAJOR COMPONENT UNITS – DISCRETELY PRESENTED

Component units are legally separate entities for which the State is financially accountable. Accountability is defined as the State's substantive appointment of a majority of the component unit's governing board. Furthermore, the State must be able to impose its will upon the component unit or there must be a possibility that the component unit may provide specific benefits to, or impose specific financial burdens on the State. The State has applied the criteria outlined in GASB Statement No. 14, The Financial Reporting Entity, in determining financial accountability. These component units are included in the financial reporting entity because of the significance of their operational or financial relationships with the State.

Nonmajor component units are comprised of the following entities:

- N.C. State Ports Authority
- N.C. Agricultural Finance Authority
- N.C. Global TransPark Authority
- N.C. Partnership for Children, Inc.
- Regional Economic Development Commissions
- North Carolina Railroad Company
- N.C. Phase II Tobacco Certification Entity, Inc.
- N.C. Turnpike Authority

**COMBINING STATEMENT OF NET ASSETS
NONMAJOR COMPONENT UNITS**

June 30, 2006

(Dollars in Thousands)

	N.C. State Ports Authority	N.C. Agricultural Finance Authority	N.C. Global TransPark Authority	N.C. Partnership for Children, Inc.	Regional Economic Development Commissions	North Carolina Railroad Company
Assets						
Cash and cash equivalents.....	\$ 6,761	\$ 4,478	\$ 10,585	\$ 247	\$ 3,950	\$ 32,737
Investments.....	10,944	—	1,820	4,307	367	—
Receivables, net.....	6,125	427	109	4,776	259	360
Due from component units.....	—	—	—	—	375	—
Inventories.....	857	2	—	—	—	—
Prepaid items.....	357	—	—	102	—	32
Notes receivable, net.....	—	11,877	—	—	—	—
Deferred charges.....	683	—	—	—	—	—
Capital assets-nondepreciable.....	89,116	172	22,075	—	67	14,224
Capital assets-depreciable, net.....	113,049	—	56,104	142	906	20,228
Total Assets.....	<u>227,892</u>	<u>16,956</u>	<u>90,693</u>	<u>9,574</u>	<u>5,924</u>	<u>67,581</u>
Liabilities						
Accounts payable and accrued liabilities...	4,841	228	197	160	73	1,386
Interest payable.....	159	—	69	—	—	—
Due to primary government.....	—	1	8,730	1,285	—	—
Unearned revenue.....	8	—	8	—	2,336	—
Advance from primary government.....	—	—	21,742	—	—	—
Deposits payable.....	—	—	—	—	—	68
Funds held for others.....	—	—	—	66	—	—
Long-term liabilities:						
Due within one year.....	2,945	2	64	13	83	—
Due in more than one year.....	51,502	24	2,643	195	—	—
Total Liabilities.....	<u>59,455</u>	<u>255</u>	<u>33,453</u>	<u>1,719</u>	<u>2,492</u>	<u>1,454</u>
Net Assets						
Invested in capital assets, net of related debt.....	148,885	172	55,638	142	973	34,452
Restricted for:						
Expendable:						
Health and human services.....	—	—	—	5,798	—	—
Other purposes.....	—	—	32	—	—	—
Unrestricted.....	19,552	16,529	1,570	1,915	2,459	31,675
Total Net Assets.....	<u>\$ 168,437</u>	<u>\$ 16,701</u>	<u>\$ 57,240</u>	<u>\$ 7,855</u>	<u>\$ 3,432</u>	<u>\$ 66,127</u>

Exhibit G-1

N.C. Phase II Tobacco Certification Entity, Inc.		N.C. Turnpike Authority	Total
\$	2,529	\$ 140	\$ 61,427
	—	—	17,438
	—	—	12,056
	—	—	375
	—	—	859
	1	—	492
	—	—	11,877
	—	—	683
	—	—	125,654
	13	34	190,476
	<u>2,543</u>	<u>174</u>	<u>421,337</u>
	—	467	7,352
	—	—	228
	—	—	10,016
	—	—	2,352
	—	3,622	25,364
	—	—	68
	58	—	124
	—	—	3,107
	—	—	54,364
	<u>58</u>	<u>4,089</u>	<u>102,975</u>
	13	34	240,309
	—	—	5,798
	—	—	32
	2,472	(3,949)	72,223
<u>\$</u>	<u>2,485</u>	<u>\$ (3,915)</u>	<u>\$ 318,362</u>

COMBINING STATEMENT OF ACTIVITIES **NONMAJOR COMPONENT UNITS**

For the Fiscal Year Ended June 30, 2006

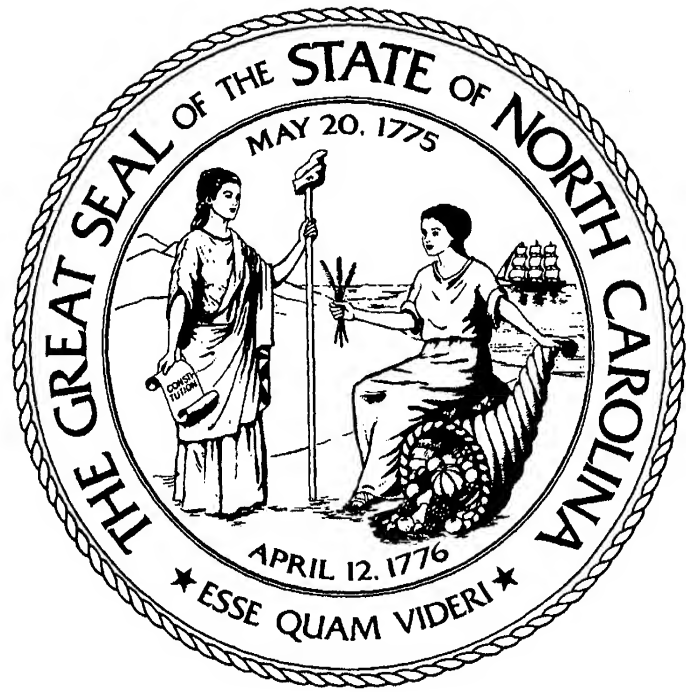
(Dollars in Thousands)

	N.C. State Ports Authority	N.C. Agricultural Finance Authority	N.C. Global TransPark Authority	N.C. Partnership for Children, Inc.	Regional Economic Development Commissions	North Carolina Railroad Company
Total expenses	\$ 39,538	\$ 823	\$ 7,566	\$ 120,033	\$ 6,378	\$ 15,274
Program revenues:						
Charges for services	40,798	984	1,195	—	508	13,217
Operating grants and contributions	6,313	444	774	6,309	1,662	925
Capital grants and contributions	—	—	715	—	—	—
Net program (expense) revenue	7,573	605	(4,882)	(113,724)	(4,208)	(1,132)
Non-tax general revenues:						
State operating aid	—	—	1,600	118,550	3,982	—
State capital aid	12,591	—	—	—	—	10,651
Miscellaneous	4,055	—	—	4	—	1,025
Total non-tax general revenues	16,646	—	1,600	118,554	3,982	11,676
Change in net assets	24,219	605	(3,282)	4,830	(226)	10,544
Net assets — July 1, as restated	144,218	16,096	60,522	3,025	3,658	55,583
Net assets — June 30	<u>\$ 168,437</u>	<u>\$ 16,701</u>	<u>\$ 57,240</u>	<u>\$ 7,855</u>	<u>\$ 3,432</u>	<u>\$ 66,127</u>

Exhibit G-2

N.C. Phase II Tobacco Certification Entity, Inc.	N.C. Turnpike Authority	Total
\$ 1,641	\$ 3,851	\$ 195,104
—	—	56,702
3,917	—	20,344
—	—	715
2,276	(3,851)	(117,343)
—	—	124,132
—	—	23,242
—	—	5,084
—	—	152,458
2,276	(3,851)	35,115
209	(64)	283,247
<u>\$ 2,485</u>	<u>\$ (3,915)</u>	<u>\$ 318,362</u>

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STATISTICAL SECTION

Index to Statistical Section

This part of the State of North Carolina's comprehensive annual financial report presents detailed information as a context for understanding what the information in the financial statements, note disclosures, and required supplementary information says about the State's overall financial health.

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These schedules contain trend information to help the reader understand how the State's financial performance has changed over time.

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Sources: Unless otherwise noted, the information in these schedules is derived from the comprehensive annual financial report for the relevant year.

NET ASSETS BY COMPONENT

Fiscal Years 2002-2006

Table 1

(Dollars in Thousands)

	2006	2005	2004	2003	2002
Governmental activities:					
Invested in capital assets, net of related debt...	\$ 28,035,283	\$ 26,434,617	\$ 24,706,355	\$ 23,449,373	\$ 22,025,039
Restricted.....	890,602	1,314,397	1,474,405	1,071,626	1,604,772
Unrestricted.....	(1,491,985)	(3,839,972)	(3,199,354)	(2,210,477)	(1,615,102)
Total governmental activities net assets..... [1]	<u>\$ 27,433,900</u>	<u>\$ 23,909,042</u>	<u>\$ 22,981,406</u>	<u>\$ 22,310,522</u>	<u>\$ 22,014,709</u>
Business-type activities:					
Invested in capital assets, net of related debt...	\$ 44,196	\$ 44,007	\$ 40,277	\$ 38,450	\$ 38,267
Restricted.....	1,286,477	970,615	665,547	863,426	797,437
Unrestricted.....	80,002	76,988	48,295	56,448	50,479
Total business-type activities net assets.....	<u>\$ 1,410,675</u>	<u>\$ 1,091,610</u>	<u>\$ 754,119</u>	<u>\$ 958,324</u>	<u>\$ 886,183</u>
Primary government:					
Invested in capital assets, net of related debt...	\$ 28,079,479	\$ 26,478,624	\$ 24,746,632	\$ 23,487,823	\$ 22,063,306
Restricted.....	2,177,079	2,285,012	2,139,952	1,935,052	2,402,209
Unrestricted.....	(1,411,983)	(3,762,984)	(3,151,059)	(2,154,029)	(1,564,623)
Total primary government net assets.....	<u>\$ 28,844,575</u>	<u>\$ 25,000,652</u>	<u>\$ 23,735,525</u>	<u>\$ 23,268,846</u>	<u>\$ 22,900,892</u>

Note: The State of North Carolina did not begin reporting government-wide statements until implementation of GASB Statement 34 in 2002.

[1] For fiscal year ended June 30, 2006, the State changed its methodology for applying GASB Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions to individual income taxes. The State now reports an estimate of underpayments of individual income taxes. The State has also changed its method to estimate overpayments of individual income taxes (i.e., income tax refunds payable and applied refunds). For the purpose of reporting underpayments, the availability period for General Fund individual income taxes was extended from thirty-one days to twelve months after year-end. Where underpayments exceed overpayments, individual income tax revenues are recognized to the extent of estimated overpayments (i.e., income tax refunds payable and applied refunds).

CHANGES IN NET ASSETS

Fiscal Years 2002-2006

(Dollars in Thousands)

	2006	2005	2004	2003	2002
Expenses					
Governmental activities:					
General government.....	\$ 1,039,513	\$ 917,209	\$ 807,248	\$ 773,835	\$ 874,208
Primary and secondary education.....	8,215,445	7,699,208	7,223,766	6,865,921	6,802,979
Higher education.....	3,472,024	3,576,384	3,140,794	2,814,375	2,519,703
Health and human services.....	13,491,119	13,375,794	11,729,904	10,614,411	10,376,807
Economic development.....	647,434	625,561	536,055	489,062	469,102
Environment and natural resources.....	676,049	570,241	599,575	537,540	627,369
Public safety, corrections, and regulation.....	2,304,900	2,125,385	2,093,404	2,034,225	2,109,487
Transportation.....	1,781,865	1,795,490	1,870,578	1,639,866	1,530,870
Agriculture.....	112,467	81,628	82,394	73,972	121,729
Interest on long-term debt.....	264,287	249,433	191,228	151,258	148,595
Total governmental activities expenses.....	<u>32,005,103</u>	<u>31,016,333</u>	<u>28,274,946</u>	<u>25,994,465</u>	<u>25,580,849</u>
Business-type activities:					
Unemployment compensation.....	849,945	824,934	1,389,266	1,603,796	1,336,718
N.C. State Lottery.....	153,125	-	-	-	-
EPA revolving loan.....	11,414	7,170	5,342	4,266	-
Regulatory commissions.....	28,526	-	-	-	-
Insurance programs.....	16,051	-	-	-	-
North Carolina State Fair.....	10,497	-	-	-	-
Other business-type activities.....	10,255	60,066	43,014	30,757	25,431
Total business-type activities expenses.....	<u>1,079,813</u>	<u>892,170</u>	<u>1,437,622</u>	<u>1,638,819</u>	<u>1,362,149</u>
Total primary government expenses.....	<u>\$ 33,084,916</u>	<u>\$ 31,908,503</u>	<u>\$ 29,712,568</u>	<u>\$ 27,633,284</u>	<u>\$ 26,942,998</u>
Program Revenues:					
Governmental activities:					
Charges for services:					
Transportation.....	\$ 725,311	\$ 588,357	\$ 553,229	\$ 526,609	\$ 524,198
Public safety, corrections, and regulation.....	411,188	378,059	371,625	355,793	327,457
General government.....	339,053	202,514	211,648	162,311	184,982
Other activities.....	512,449	503,552	368,588	306,036	276,322
Operating grants and contributions.....	11,503,844	11,380,864	10,108,124	9,043,064	8,787,254
Capital grants and contributions.....	914,090	1,011,451	884,345	527,498	714,084
Total governmental activities program revenues.....	<u>14,405,935</u>	<u>14,064,797</u>	<u>12,497,559</u>	<u>10,921,311</u>	<u>10,814,297</u>
Business-type activities:					
Charges for services:					
Unemployment compensation.....	1,101,357	1,062,549	878,722	646,273	433,364
N.C. State Lottery.....	216,906	-	-	-	-
EPA revolving loan.....	15,237	14,078	13,876	12,550	-
Regulatory commissions.....	33,550	-	-	-	-
Insurance programs.....	14,860	-	-	-	-
North Carolina State Fair.....	12,581	-	-	-	-
Other business-type activities.....	7,973	69,349	34,293	29,694	27,477
Operating grants and contributions.....	64,085	54,760	305,053	504,550	438,760
Capital grants and contributions.....	258	452	892	1,241	1,121
Total business-type activities program revenues.....	<u>1,466,807</u>	<u>1,201,188</u>	<u>1,232,836</u>	<u>1,194,308</u>	<u>900,722</u>
Total primary government program revenues.....	<u>\$ 15,872,742</u>	<u>\$ 15,265,985</u>	<u>\$ 13,730,395</u>	<u>\$ 12,115,619</u>	<u>\$ 11,715,019</u>
Net (expense) revenue					
Governmental activities.....	\$ (17,599,168)	\$ (16,951,536)	\$ (15,777,387)	\$ (15,073,154)	\$ (14,766,552)
Business-type activities.....	386,994	309,018	(204,786)	(444,511)	(461,427)
Total primary government net expense.....	<u>\$ (17,212,174)</u>	<u>\$ (16,642,518)</u>	<u>\$ (15,982,173)</u>	<u>\$ (15,517,665)</u>	<u>\$ (15,227,979)</u>

Table 2

	2006	2005	2004	2003	2002
General Revenues and Other Changes in Net Assets					
Governmental activities:					
Taxes					
Individual income tax..... [1]	\$ 9,336,745	\$ 8,244,275	\$ 7,407,455	\$ 7,122,099	\$ 7,234,431
Corporate income tax.....	1,306,193	1,143,458	760,180	921,611	599,382
Sales and use tax.....	5,033,040	4,621,098	4,293,040	4,029,403	3,778,873
Gasoline tax.....	1,514,626	1,354,699	1,276,627	1,154,986	1,212,788
Franchise tax.....	628,029	613,033	560,708	584,584	590,992
Highway use tax.....	577,237	580,118	578,346	552,759	555,320
Insurance tax.....	442,297	442,228	432,975	417,126	347,893
Beverage tax.....	233,315	220,782	213,271	198,848	200,593
Inheritance tax.....	133,158	135,107	128,352	112,150	106,491
Other tax.....	482,552	306,991	313,985	289,261	278,740
Tobacco settlement.....	140,969	148,800	147,224	173,256	175,836
Federal grants not restricted to specific programs.....	-	-	136,859	136,859	139,350
Unrestricted investment earnings.....	123,170	78,546	77,225	103,987	-
Miscellaneous.....	37,248	53,488	62,601	41,137	57,484
Contributions to permanent funds.....	4,674	2,288	2,068	1,806	2,019
Transfers.....	67,978	(11,620)	(302)	4,918	47,957
Total governmental activities.....	<u>20,061,231</u>	<u>17,933,291</u>	<u>16,390,614</u>	<u>15,844,790</u>	<u>15,328,149</u>
Business-type activities:					
Miscellaneous.....	4	79	3	-	-
Transfers.....	(67,978)	11,620	302	(4,918)	(47,957)
Total business-type activities.....	<u>(67,974)</u>	<u>11,699</u>	<u>305</u>	<u>(4,918)</u>	<u>(47,957)</u>
Total primary government.....	<u>\$ 19,993,257</u>	<u>\$ 17,944,990</u>	<u>\$ 16,390,919</u>	<u>\$ 15,839,872</u>	<u>\$ 15,280,192</u>
Change in Net Assets					
Governmental activities.....	\$ 2,462,063	\$ 981,755	\$ 613,227	\$ 771,636	\$ 561,597
Business-type activities.....	319,020	320,717	(204,481)	(449,429)	(509,384)
Total primary government.....	<u>\$ 2,781,083</u>	<u>\$ 1,302,472</u>	<u>\$ 408,746</u>	<u>\$ 322,207</u>	<u>\$ 52,213</u>

Note: The State of North Carolina did not begin reporting government-wide statements until implementation of GASB Statement 34 in 2002.

[1] For fiscal year ended June 30, 2006, the State changed its methodology for applying GASB Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions to individual income taxes. The State now reports an estimate of underpayments of individual income taxes. The State has also changed its method to estimate overpayments of individual income taxes (i.e., income tax refunds payable and applied refunds). For the purpose of reporting underpayments, the availability period for General Fund individual income taxes was extended from thirty-one days to twelve months after year-end. Where underpayments exceed overpayments, individual income tax revenues are recognized to the extent of estimated overpayments (i.e., income tax refunds payable and applied refunds).

FUND BALANCES OF GOVERNMENTAL FUNDS

Fiscal Years 2002-2006

Table 3

(Dollars in Thousands)

	2006	2005	2004	2003	2002
General Fund					
Reserved.....	\$ 155,418	\$ 172,633	\$ 197,448	\$ 166,172	\$ 227,767
Unreserved.....	1,769,780	(251,442)	(393,735)	(333,127)	(576,318)
Total General Fund.....	<u>\$ 1,925,198</u>	<u>\$ (78,809)</u>	<u>\$ (196,287)</u>	<u>\$ (166,955)</u>	<u>\$ (348,551)</u>
All Other Governmental Funds					
Reserved.....	\$ 961,136	\$ 911,966	\$ 847,174	\$ 672,653	\$ 1,099,039
Unreserved, reported in:					
Special revenue funds.....	2,232,200	2,170,533	2,260,374	2,041,905	2,254,227
Capital projects funds.....	113,433	44,237	110,395	84,677	73,751
Permanent funds.....	1,518	2,645	2,380	6,903	226
Total all other governmental funds.....	<u>\$ 3,308,287</u>	<u>\$ 3,129,381</u>	<u>\$ 3,220,323</u>	<u>\$ 2,806,138</u>	<u>\$ 3,427,243</u>

Note: Due to changes in the State's fund structure initiated when GASB Statement 34 was implemented, the changes in fund balance information is not available before 2002.

[1] For fiscal year ended June 30, 2006, the State changed its methodology for applying GASB Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions to individual income taxes. The State now reports an estimate of underpayments of individual income taxes. The State has also changed its method to estimate overpayments of individual income taxes (i.e., income tax refunds payable and applied refunds). For the purpose of reporting underpayments, the availability period for General Fund individual income taxes was extended from thirty-one days to twelve months after year-end. Where underpayments exceed overpayments, individual income tax revenues are recognized to the extent of estimated overpayments (i.e., income tax refunds payable and applied refunds).

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CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS

Fiscal Years 1997-2006

(Dollars in Thousands)

		<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
<u>Revenues</u>						
Taxes.....	[5]	\$ 19,848,465	\$ 17,618,730	\$ 15,961,629	\$ 15,394,024	\$ 14,894,796
Federal funds.....		11,315,722	11,287,454	10,089,075	8,672,065	8,459,344
Local funds.....		610,501	767,067	657,954	586,638	702,076
Investment earnings.....	[2]	384,014	292,406	160,846	320,023	335,082
Interest earnings on loans.....		5,405	5,664	5,801	7,165	47,421
Sales and services.....		260,538	235,894	210,161	184,739	194,548
Rental and lease of property.....		25,982	38,585	27,848	22,175	24,359
Fees, licenses and fines.....		1,405,569	1,218,431	1,035,303	915,380	864,912
Tobacco settlement.....		136,453	148,641	146,452	173,256	175,836
Contributions, gifts, and grants.....		118,936	108,450	150,731	90,486	93,802
Funds escheated.....		108,075	49,684	55,330	41,369	90,181
Federal funds for fiscal relief.....		—	—	136,859	136,859	N/A
Miscellaneous.....		161,052	146,529	196,937	147,777	145,887
Total revenues.....	[3]	<u>34,380,712</u>	<u>31,917,535</u>	<u>28,834,926</u>	<u>26,691,956</u>	<u>26,028,244</u>
<u>Expenditures</u>						
Current:						
General government.....		963,899	754,175	711,327	691,267	809,398
Education.....	[4]	N/A	N/A	N/A	N/A	N/A
Primary and secondary education.....	[4]	8,211,998	7,713,265	7,223,143	6,863,338	6,802,662
Higher education.....	[4]	3,471,604	3,576,766	3,140,698	2,813,629	2,519,624
Health and human services.....	[1]	13,318,071	13,376,364	11,722,721	10,583,184	10,398,386
Economic development.....		643,510	622,000	532,674	484,298	498,644
Environment and natural resources.....	[1]	626,442	579,853	581,726	534,405	574,871
Public safety, corrections, and regulation.....		2,291,596	2,123,837	2,073,338	1,998,576	2,070,166
Transportation.....		3,219,549	3,511,161	3,389,042	2,967,551	2,992,187
Agriculture.....		110,626	82,508	81,488	81,857	122,337
Retiree tax judgements.....		—	—	—	—	—
Capital outlay.....		270,882	313,932	385,506	104,379	126,011
Debt service:						
Principal.....		367,946	303,818	235,792	168,009	180,398
Interest.....		288,088	241,936	185,350	152,110	147,580
Debt issuance cost.....		1,645	7,454	4,830	1,410	734
Total expenditures.....	[3]	<u>33,785,856</u>	<u>33,207,069</u>	<u>30,267,635</u>	<u>27,444,013</u>	<u>27,242,998</u>
Excess revenues over (under) expenditures.....		<u>594,856</u>	<u>(1,289,534)</u>	<u>(1,432,709)</u>	<u>(752,057)</u>	<u>(1,214,754)</u>
<u>Other Financing Sources (Uses)</u>						
Bonds issued.....		370,000	1,075,140	1,377,560	711,600	605,000
Certificates of participation issued.....		—	188,385	283,955	17,500	—
Refunding bonds issued.....		—	959,665	326,710	556,350	—
Other debt issued.....		30,688	12,686	17,597	—	4,832
Premium on debt issued.....		16,338	210,116	137,256	25,017	14,733
Discount on debt issued.....		—	—	—	(254)	—
Payments to refunded bond escrow agent.....		—	(1,059,663)	(346,915)	(558,444)	—
Capital leases.....		26,745	212	—	150	216
Sale of capital assets.....		20,131	14,674	10,105	8,882	12,570
Insurance recoveries.....		6,537	—	—	—	—
Transfers in.....		1,784,222	1,754,448	1,566,520	1,587,388	1,478,308
Transfers out.....		(1,718,585)	(1,760,801)	(1,557,208)	(1,583,075)	(1,414,418)
Total other financing sources (uses).....		<u>536,076</u>	<u>1,394,862</u>	<u>1,815,580</u>	<u>765,114</u>	<u>701,241</u>
Net change in fund balances.....		<u>\$ 1,130,932</u>	<u>\$ 105,328</u>	<u>\$ 382,871</u>	<u>\$ 13,057</u>	<u>\$ (513,513)</u>
Debt service as a percentage of noncapital expenditures...		2.07%	1.80%	1.53%	1.26%	1.30%

All governmental fund types consist of the General Fund, special revenue funds, capital projects funds, and permanent funds. Years prior to 2002 do not include permanent funds.

Table 4

2001	2000	1999	1998	1997
\$ 15,147,177	\$ 14,569,104	\$ 13,817,577	\$ 13,287,609	\$ 12,177,605
7,924,893	7,253,282	6,297,196	5,983,003	5,857,680
760,607	511,350	469,539	462,879	427,306
487,824	500,854	529,028	575,901	454,678
5,789	5,356	6,665	5,676	4,280
97,686	94,751	92,237	84,087	76,130
43,046	25,059	26,913	26,321	24,738
896,435	1,046,042	895,892	826,491	814,690
140,272	—	N/A	N/A	N/A
122,871	79,554	71,787	61,189	31,805
N/A	N/A	N/A	N/A	N/A
N/A	N/A	N/A	N/A	N/A
165,349	147,816	172,103	148,794	182,247
25,791,949	24,233,168	22,378,937	21,461,950	20,051,159
1,035,440	1,229,513	1,039,855	1,115,763	921,406
6,964,812	6,674,757	6,253,838	5,416,486	4,775,741
N/A	N/A	N/A	N/A	N/A
N/A	N/A	N/A	N/A	N/A
9,617,423	8,411,025	7,665,461	7,300,262	6,822,624
453,931	428,819	370,124	321,613	294,787
459,170	371,238	354,025	332,803	668,402
1,948,423	1,999,894	1,670,703	1,578,985	1,613,757
2,820,290	2,598,605	2,508,886	2,384,455	2,205,494
88,623	143,936	72,562	68,573	65,421
58,679	440,000	399,000	400,000	—
155,228	159,241	182,793	203,605	147,194
151,120	141,934	123,952	91,585	82,710
130,343	122,943	103,678	78,454	48,539
N/A	N/A	N/A	N/A	N/A
23,883,482	22,721,905	20,744,877	19,292,584	17,646,075
1,908,467	1,511,263	1,634,060	2,169,366	2,405,084
680,000	200,000	450,055	700,000	645,000
—	—	—	—	—
—	—	26,182	—	—
—	—	—	—	—
—	—	—	—	—
—	—	—	—	—
—	—	(26,182)	—	—
—	339	841	—	247
—	—	—	—	—
1,415,317	1,573,875	1,273,470	1,215,549	1,205,077
(1,427,607)	(1,576,980)	(1,307,996)	(1,217,753)	1,190,085
667,710	197,234	416,370	697,796	3,040,409
\$ 2,576,177	\$ 1,708,497	\$ 2,050,430	\$ 2,867,162	\$ 5,445,493
1.26%	1.24%	1.17%	0.94%	0.79%

[1] In fiscal years prior to 1998, health expenditures were included in the environment, health and natural resources expenditure function. In the 1998 fiscal year, health expenditures were shifted and are now reflected in the health and human services function.

[2] Fiscal years prior to 1998 do not reflect the implementation of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*.

[3] Fiscal years prior to 2001 do not reflect the implementation of GASB Statement No. 33, *Accounting for Nonexchange Transactions*. This statement provided new rules on the timing of recognition of nonexchange transactions involving financial or capital resources.

[4] Fiscal years prior to 2002 do not reflect the implementation of GASB - Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* (as amended by Statement No. 37). This statement establishes new financial reporting requirements for state and local governments throughout the United States.

[5] For fiscal year ended June 30, 2006, the State changed its methodology for applying GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* to individual income taxes. The State now reports an estimate of underpayments of individual income taxes. The State has also changed its method to estimate overpayments of individual income taxes (i.e., income tax refunds payable and applied refunds). For the purpose of reporting underpayments, the availability period for General Fund individual income taxes was extended from thirty-one days to twelve months after year-end. Where underpayments exceed overpayments, individual income tax revenues are recognized to the extent of estimated overpayments (i.e., income tax refunds payable and applied refunds).

SCHEDULE OF REVENUES BY SOURCE — GENERAL FUND **GAAP BASIS**

Fiscal Years 1997-2006

(Dollars in Thousands)

	2006	2005	2004	2003	2002
TAX REVENUES					
Individual income tax..... [3]	\$ 9,493,714	\$ 8,206,026	\$ 7,404,956	\$ 7,126,655	\$ 7,219,794
Corporate income tax.....	1,208,356	1,065,374	699,441	922,936	548,046
Sales and use tax.....	5,007,567	4,587,542	4,268,292	4,020,923	3,766,285
Franchise tax.....	628,665	613,093	560,502	583,781	592,259
Beverage tax.....	232,987	220,782	213,271	198,848	200,593
Insurance tax.....	431,729	431,664	423,405	408,873	340,785
Piped natural gas.....	58,397	60,739	64,327	63,219	64,852
Intangible tax.....	—	—	—	—	—
Inheritance tax.....	133,248	134,419	129,579	112,605	104,799
Soft drink tax.....	—	—	—	—	2
Tobacco products tax.....	187,566	43,361	44,126	41,899	41,500
License tax.....	46,035	44,219	42,418	44,565	44,432
Real estate conveyance tax.....	—	—	—	—	—
Gift tax.....	16,251	18,924	16,615	19,328	13,392
Other taxes.....	27,571	14,114	13,571	12,508	17,479
Total tax revenues.....	17,472,086	15,440,257	13,880,503	13,556,140	12,954,218
NON-TAX REVENUES					
Federal Funds:					
Departmental revenues.....	9,905,879	9,755,067	8,769,925	7,564,627	7,266,016
Federal Funds for Fiscal Relief:					
Federal funds for fiscal relief.....	—	—	136,859	136,859	—
Local Funds:					
Departmental revenues.....	574,300	731,368	636,900	562,498	682,310
Investment Earnings:					
Income from General Fund investments..... [1]	122,405	75,669	76,415	103,786	129,924
Income from securities lending.....	133,098	48,463	21,305	30,604	44,659
Departmental revenues.....	7,357	8,539	2,613	4,745	4,217
Other investment earnings.....	44	14	3	5	9,531
	262,904	132,685	100,336	139,140	188,331
Sales and Services:					
Departmental revenues.....	94,994	85,592	76,010	61,316	61,031
Other non-tax revenues.....	184	168	182	198	228
	95,178	85,760	76,192	61,514	61,259
Rental and Lease of Property:					
Proceeds from rental and lease of property.....	57	4,304	102	92	546
Departmental revenues.....	7,885	7,072	6,620	6,140	6,556
	7,942	11,376	6,722	6,232	7,102
Fees, Licenses and Fines:					
Court fines and fees.....	158,646	142,798	138,878	126,381	109,575
Secretary of State service fees.....	55,976	46,975	40,638	36,807	31,357
Banking and investment fees.....	5,386	5,165	4,758	4,485	4,336
Self insurer fees (Industrial Commission).....	14,269	14,128	13,777	13,512	6,795
Probation supervision fees.....	16,471	16,476	16,748	14,339	10,833
Department of Insurance fees.....	25,990	24,526	25,147	21,198	22,854
DWI service and restoration fees.....	8,420	8,398	8,709	7,332	5,822
Departmental revenues.....	210,687	200,452	62,578	41,747	41,540
Other non-tax revenues.....	5,173	3,818	4,388	4,161	4,124
	501,018	462,736	315,621	269,962	237,236
Tobacco settlement					
Tobacco settlement.....	136,453	148,641	146,452	173,256	175,836
Contributions, Gifts and Grants:					
Departmental revenues.....	17,632	34,375	50,140	29,702	33,658
Other non-tax revenues.....	1	105	234	1	30
	17,633	34,480	50,374	29,703	33,688
Miscellaneous:					
Local sales and use tax administration.....	14,356	13,932	13,989	12,495	11,774
Sales tax refunds.....	3,014	10,253	14,456	7,908	11,120
Departmental revenues.....	113,171	84,927	123,852	95,753	89,489
Other non-tax revenue.....	1,302	1,253	2,083	315	6,307
	131,843	110,365	154,380	116,471	118,690
Total non-tax revenues.....	11,633,150	11,472,478	10,393,781	9,060,262	8,770,468
Total Revenues..... [2], [3]	\$ 29,105,236	\$ 26,912,735	\$ 24,274,284	\$ 22,616,402	\$ 21,724,686

Table 5

2001	2000	1999	1998	1997
\$ 7,605,542	\$ 7,097,514	\$ 6,586,153	\$ 6,124,709	\$ 5,454,571
712,161	989,280	920,583	999,759	869,717
3,429,532	3,361,189	3,342,157	3,272,774	3,134,877
746,687	557,544	567,497	567,869	534,622
198,646	193,003	182,970	155,352	151,064
305,791	273,367	291,202	283,828	259,286
64,854	52,025	—	—	—
4	20	31	217	—
123,094	162,997	163,608	144,203	132,195
48	144	11,463	22,338	30,980
42,137	43,104	44,694	47,304	46,797
43,874	42,595	27,202	38,209	41,280
—	—	1,215	894	1,064
20,254	25,084	19,243	20,722	12,566
11,152	10,292	10,973	1,501	1,516
13,303,776	12,808,158	12,168,991	11,679,679	10,670,535
6,777,503	6,156,189	5,361,839	5,174,406	5,169,286
—	—	—	—	—
737,063	482,387	436,609	436,347	403,145
163,479	204,083	248,657	252,162	224,260
111,490	112,011	112,531	136,955	105,722
10,022	7,300	4,416	58,415	10,257
320	251	81	137	241
285,311	323,645	365,685	447,669	340,480
68,736	69,793	70,036	67,214	58,744
405	276	350	319	—
69,141	70,069	70,386	67,533	58,744
573	1,035	786	1,811	1,342
16,989	7,218	5,773	4,255	4,651
17,562	8,253	6,559	6,066	5,993
111,012	97,808	99,986	93,252	99,819
29,584	24,255	20,099	19,257	17,344
10,914	4,029	4,332	3,031	3,337
7,098	6,360	4,128	3,556	3,460
10,453	10,605	11,166	11,778	10,859
20,210	18,433	18,205	1,096	6,001
5,706	5,703	5,936	6,050	5,949
40,422	38,300	110,664	103,296	104,002
4,065	4,181	2,652	3,358	4,075
239,464	209,674	277,168	244,674	254,846
140,272	—	—	—	—
53,425	15,452	17,511	13,205	14,145
—	2	101	1	—
53,425	15,454	17,612	13,206	14,145
11,568	10,973	10,293	10,060	9,178
11,494	15,514	10,406	10,936	13,301
123,230	108,555	130,518	115,529	151,906
914	866	844	744	455
147,206	135,908	152,061	137,269	174,840
8,466,947	7,401,579	6,687,919	6,527,170	6,421,479
\$ 21,770,723	\$ 20,209,737	\$ 18,856,910	\$ 18,206,849	\$ 17,092,014

[1] Fiscal years prior to 1998 do not reflect the implementation of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*.

[2] Fiscal years prior to 2001 do not reflect the implementation of GASB Statement No. 33, *Accounting for Nonexchange Transactions*. This statement provided new rules on the timing of recognition of nonexchange transactions involving financial or capital resources.

[3] For fiscal year ended June 30, 2006, the State changed its methodology for applying GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* to individual income taxes. The State now reports an estimate of underpayments of individual income taxes. The State has also changed its method to estimate overpayments of individual income taxes (i.e., income tax refunds payable and applied refunds). For the purpose of reporting underpayments, the availability period for General Fund individual income taxes was extended from thirty-one days to twelve months after year-end. Where underpayments exceed overpayments, individual income tax revenues are recognized to the extent of estimated overpayments (i.e., income tax refunds payable and applied refunds).

PERSONAL INCOME BY INDUSTRY

For the Fiscal Years 1998-2004

Table 6

(Dollars in thousands)

	2004	2003	2002	2001	2000	1999	1998
Manufacturing.....	\$ 33,357,779	\$ 32,754,580	\$ 32,957,483	\$ 33,339,686	\$ 35,305,549	\$ 33,669,223	\$ 32,650,010
Retail trade.....	13,551,202	13,006,050	12,770,117	12,587,584	14,265,654	13,517,581	12,414,512
Services.....	56,189,445	52,183,987	50,615,389	48,236,817	34,278,925	31,337,093	28,119,353
Agricultural, forestry, fishing, etc....	644,207	620,240	600,946	618,682	907,049	827,266	738,696
Government.....	36,998,898	34,625,046	32,293,906	30,616,692	29,435,566	27,538,020	26,140,579
Construction.....	12,041,280	10,974,223	11,039,949	11,565,880	8,799,938	8,300,149	7,592,861
Wholesale trade.....	10,445,588	9,575,312	9,033,833	8,588,296	9,641,533	9,108,928	8,511,319
Transportation and warehousing.....	5,865,758	5,527,864	5,428,763	5,324,201	5,073,577	4,808,932	4,542,317
Finance and insurance.....	11,517,449	10,837,137	10,132,069	9,440,396	9,343,795	8,469,976	7,742,498
Mining.....	270,876	241,841	240,364	278,288	212,489	206,714	201,577
Utilities.....	1,431,754	1,373,889	1,275,067	[1]	[1]	[1]	[1]
Information.....	5,287,111	5,117,192	5,138,686	[1]	[1]	[1]	[1]
Real estate and rental and leasing.....	3,892,638	3,409,047	3,304,984	3,268,078	1,264,710	1,180,757	1,083,707
Total.....	<u>\$ 191,493,985</u>	<u>\$ 180,246,408</u>	<u>\$ 174,831,556</u>	<u>\$ 163,864,600</u>	<u>\$ 148,528,785</u>	<u>\$ 138,964,639</u>	<u>\$ 129,737,429</u>
Average effective rate [2]:							
Individual income tax.....	3.9%	4.0%	4.1%	4.6%	4.8%	4.7%	4.7%

[1] 2002 is the first fiscal year data was collected for this industry.

[2] Average effective rate equals individual income tax revenues divided by personal income.

Source: Bureau of Economic Analysis(Data for 2006 & 2005 is not available.)

Information prior to 1998 was not available.

Individual Income Tax Filers and Liability - Calendar Years 1997 and 2004

Individual Income Tax Rates - Calendar Years 1997-2006

Table 7

North Carolina Taxable Income	Individual Income Tax Filers and Liability by Income Level							
	Calendar Year 2004				Calendar Year 1997			
	Number of Returns	% of Total	Tax Liability	% of Total	Number of Returns	% of Total	Tax Liability	% of Total
0 to \$15,000.....	1,915,154	51.7%	\$ 428,487,839	5.5%	1,905,113	55.1%	\$ 488,197,412	8.6%
\$15,001 to \$25,000.....	503,980	13.6%	573,559,493	7.4%	511,583	14.8%	594,444,487	10.5%
\$25,001 to \$50,000.....	679,126	18.4%	1,505,488,492	19.5%	651,213	18.8%	1,439,015,941	25.5%
\$50,001 to \$75,000.....	298,366	8.1%	1,167,572,328	15.1%	216,854	6.3%	841,378,659	14.9%
\$75,001 to \$100,000.....	125,044	3.4%	712,487,586	9.2%	73,427	2.1%	418,097,539	7.4%
\$100,001 to \$200,000.....	124,333	3.4%	1,140,284,098	14.8%	70,304	2.0%	649,278,481	11.5%
\$200,001 and up.....	52,807	1.4%	2,193,551,650	28.5%	32,224	0.9%	1,220,905,346	21.6%
	<u>3,698,810</u>	100.0%	<u>\$ 7,721,431,486</u>	100.0%	<u>3,460,718</u>	100.0%	<u>\$ 5,651,317,865</u>	100.0%

Note: Due to confidentiality issues, the names of the ten largest revenue payers are not available. The categories presented are intended to provide alternative information regarding the sources of the State's revenue. Calendar year 2004 is the most recent year for which data are available.

Individual Income Tax Rates - Last 10 Years

1997-2000				
Tax Year	Bracket 1	Bracket 2	Bracket 3	Bracket 4
Married - Joint:				
Taxable income	\$1-\$21,250	\$21,251-\$100,000	> \$100,000	
Tax rate	6%	7%	7.75%	
Married - Separate:				
Taxable income	\$1-\$10,625	\$10,626-\$50,000	> \$50,000	
Tax rate	6%	7%	7.75%	
Head of Household:				
Taxable income	\$1-\$17,000	\$17,001-\$80,000	> \$80,000	
Tax rate	6%	7%	7.75%	
Single:				
Taxable income	\$1-\$12,750	\$12,751-\$60,000	> \$60,000	
Tax rate	6%	7%	7.75%	

Temporary Rate Increase -

Effective for the tax years January 1, 2001 through December 31, 2003, the General Assembly temporarily raised the highest individual income tax rate from 7.75% to 8.25%. This temporary increase was extended in subsequent budgets. In 2006-07, the General Assembly reduced the top rate from 8.25% to 8.0%, effective January 1, 2007.

2001-2006				
Tax Year	Bracket 1	Bracket 2	Bracket 3	Bracket 4
Married - Joint:				
Taxable income	\$1-\$21,250	\$21,251-\$100,000	\$100,001-\$200,000	> \$200,000
Tax rate	6%	7%	7.75%	8.25%
Married - Separate:				
Taxable income	\$1-\$10,625	\$10,626-\$50,000	\$50,001-\$100,000	> \$100,000
Tax rate	6%	7%	7.75%	8.25%
Head of Household:				
Taxable income	\$1-\$17,000	\$17,001-\$80,000	\$80,001-\$160,000	> \$160,000
Tax rate	6%	7%	7.75%	8.25%
Single:				
Taxable income	\$1-\$12,750	\$12,751-\$60,000	\$60,001-\$120,000	> \$120,000
Tax rate	6%	7%	7.75%	8.25%

Income tax rate restrictions -

The State Constitution (Article V, section 2(6)) places the following limitation on the income tax: "The rate of tax on incomes shall not in any case exceed ten percent, and there shall be allowed personal exemptions and deductions so that only net incomes are taxed".

TAXABLE SALES BY BUSINESS GROUP

For the Fiscal Year 2006

Table 8

(Dollars in Thousands)

	<u>2006</u>
General merchandise.....	\$ 24,141,458
Food.....	17,333,935
Lumber & building material.....	14,749,083
Automotive.....	5,416,622
1%, 2%, 2.5% and 3% Tax group.....	4,551,097
Furniture.....	4,387,923
Apparel.....	3,481,573
Unclassified.....	27,490,165
Total.....	<u>\$ 101,551,856</u>
Direct sales tax rate	4.5%

Source: North Carolina Department of Revenue (Prior year data was not available.)

SALES TAX REVENUE PAYERS BY BUSINESS GROUP

Fiscal Years 1998 and 2005

Table 9

	2005		1998	
	Tax Liability	Percentage of Total	Tax Liability	Percentage of Total
General merchandise.....	\$ 987,088,322	20.35%	\$ 625,352,352	19.33%
Food.....	725,611,884	14.96%	740,721,893	22.90%
Utilities.....	669,470,423	13.80%	351,593,637	10.87%
Lumber & building material.....	594,458,884	12.25%	342,385,447	10.59%
Automotive.....	254,507,573	5.25%	182,729,329	5.65%
Furniture.....	181,087,138	3.73%	142,354,550	4.40%
Apparel.....	142,766,762	2.94%	100,886,318	3.12%
Farming.....	46,272,351	0.95%	54,697,552	1.69%
Unclassified.....	1,249,760,813	25.77%	693,807,982	21.45%
Total.....	<u>\$ 4,851,024,150</u>	100.00%	<u>\$ 3,234,529,060</u>	100.00%
General state sales tax rate.....	4.5%		4.0%	

Information prior to 1998 is not available.

Recent Significant Sales Tax Rate and Base Changes

1998-99	Effective July 1, 1998, the State rate applicable to food purchased for home consumption was reduced from 3% to 2%. Effective May 1, 1999, food purchased for home consumption was exempted from the State sales tax.
1999-00	Effective July 1, 1999, sales of piped natural gas became exempt from sales tax and, instead, became subject to the piped natural gas excise tax.
2001-02	Effective October 16, 2001, the general sales rate increased from 4% to 4.5%. Effective December 1, 2001, sales of spirituous liquor, other than mixed beverages, became subject to a 6% State sales and use tax. Effective January 1, 2002, gross receipts of direct-to-home satellite service to subscribers in this State became subject to a 5% State sales tax. Effective January 1, 2002, gross receipts derived from providing telecommunications services became subject to a 6% State sales and use tax. (Prior to the law change, local telecommunications services were subject to a 3% State sales tax rate and a 3.22% utility franchise tax rate; interstate long distance calls were taxed at 6.5% and interstate long distance calls were exempt.)
2003-04	Effective July 1, 2003, all sales of soft drinks became subject to both the State and local rates. Effective January 1, 2004, sales of closed container soft drinks sold through vending machines were taxed on only 50% of the sale price. Effective January 1, 2004, candy was exempted from the State tax and subject to only the 2% local tax. Effective for sales made on or after January 1, 2004, modular homes became subject to a 2.5% State sales and use tax rate.
2005-06	Effective October 1, 2005, all sales of candy became subject to the combined general State and county tax rate. Effective October 1, 2005, the sales and use tax imposed on telecommunications, direct-to-home satellite services, and spirituous liquor increased to 7%. Effective January 1, 2006, a 7% State sales and use tax was imposed on cable services, and satellite digital audio radio became subject to both the State general rate of tax and local rates.

Source: North Carolina Department of Revenue

RATIOS OF OUTSTANDING DEBT BY TYPE

For the Fiscal Years 1997-2006

(Dollars in Thousands)

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>
Governmental Activities					
General obligation bonds.....	\$ 5,738,815	\$ 5,698,535	\$ 4,982,860	\$ 4,066,990	\$ 3,467,325
Lease-purchase revenue bonds.....	255,045	265,045	218,405	-	-
Certificates of participation.....	454,060	475,170	301,165	17,500	-
Tax judgements payable.....	-	-	-	-	-
Claims payable.....	-	-	-	-	-
Notes payable.....	60,841	34,007	25,008	9,629	11,753
Capital leases payable.....	26,879	330	304	322	216
Total Governmental Activities.....	<u>6,535,640</u>	<u>6,473,087</u>	<u>5,527,742</u>	<u>4,094,441</u>	<u>3,479,294</u>
Business-type activities					
Revenue bonds.....	\$ 8,800	9,070	9,325	9,570	9,805
Notes payable.....	1,457	1,569	-	-	-
Total Business-type Activities.....	<u>10,257</u>	<u>10,639</u>	<u>9,325</u>	<u>9,570</u>	<u>9,805</u>
Total Primary Government.....	<u>\$ 6,545,897</u>	<u>\$ 6,483,726</u>	<u>\$ 5,537,067</u>	<u>\$ 4,104,011</u>	<u>\$ 3,489,099</u>
Debt as a Percentage of Personal Income.....	2.32%	2.44%	2.22%	1.73%	1.52%
Amount of Debt per Capita.....	\$ 742	\$ 747	\$ 648	\$ 488	\$ 419

Table 10

<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>1997</u>
\$ 3,038,693	\$ 2,509,986	\$ 2,451,973	\$ 2,123,944	\$ 1,514,477
-	-	-	-	-
-	-	-	-	-
-	58,744	440,000	732,000	-
-	-	-	-	20
7,870	8,797	3,270	4,166	6,083
-	853	904	190	318
<u>3,046,563</u>	<u>2,578,380</u>	<u>2,896,147</u>	<u>2,860,300</u>	<u>1,520,898</u>
9,905	-	-	-	-
-	-	-	-	-
<u>9,905</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<u>\$ 3,056,468</u>	<u>\$ 2,578,380</u>	<u>\$ 2,896,147</u>	<u>\$ 2,860,300</u>	<u>\$ 1,520,898</u>
1.33%	1.12%	1.26%	1.25%	0.66%
\$ 367	\$ 310	\$ 348	\$ 344	\$ 183

RATIOS OF GENERAL BONDED AND SIMILAR DEBT OUTSTANDING

For the Fiscal Years 1997-2006

Table 11

Fiscal Year Ended June 30	General Obligation Bonds	Lease Purchase Revenue Bonds	Certificates of Participation	Total	Per Capita
2006	\$ 5,738,815,000	\$ 255,045,000	\$ 454,060,000	\$ 6,447,920,000	\$ 730.45
2005	5,698,535,000	265,045,000	475,170,000	6,438,750,000	741.51
2004	4,982,860,000	218,405,000	301,165,000	5,502,430,000	644.22
2003	4,066,990,000	-	1,750,000	4,068,740,000	483.96
2002	3,467,326,000	-	-	3,467,326,000	416.74
2001	3,042,570,000	-	-	3,042,570,000	371.67
2000	2,514,730,000	-	-	2,514,730,000	312.42
1999	2,457,650,000	-	-	2,457,650,000	321.35
1998	2,130,615,000	-	-	2,130,615,000	282.36
1997	1,522,200,000	-	-	1,522,200,000	204.91

Note: Population data can be found in table 15.

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SCHEDULE OF GENERAL OBLIGATION BONDS PAYABLE

June 30, 2006

(Dollars in Thousands)

<i>Payable from General Fund Revenues</i>								
	Total General Obligation Bonds	Total General Fund	Capital Improve- ment Series 1989 5-1-89 6.5 - 6.9%	Capital Improve- ment Series 1997 1-1-97 4.8-5.1%	Public School Building Series 1997A 3-1-97 5.1-5.2%	Public School Building Series 1998A 4-1-98 4.75-5.0%	Public School Building Series 1999 4-1-99 4.5-5.0%	Clean Water Refunding Series 1999 4-1-99 2.9-5.0%
Bonds Authorized and Issued:			[*]					
Ch. 1048, 1987 session law.	\$ 20,499	\$ 20,499	\$ 20,499	\$ —	\$ —	\$ —	\$ —	\$ —
Ch. 542, 1993 session law...	195,000	195,000	—	195,000	—	—	—	—
Ch. 631, 1995 session law...	1,800,000	1,800,000	—	—	450,000	450,000	450,000	—
General Statute Ch. 142.....	908,965	908,965	—	—	—	—	—	25,905
Ch. 590, 1995 session law...	650,000	—	—	—	—	—	—	—
Ch. 132, 1998 session law...	717,955	717,955	—	—	—	—	—	—
Ch. 3, 2000 session law.....	2,122,800	2,122,800	—	—	—	—	—	—
2004 session law.....	1,981,165	1,582,795	—	—	—	—	—	—
Total bonds authorized and issued.....	8,396,384	7,348,014	20,499	195,000	450,000	450,000	450,000	25,905
Accretion.....	15,880	15,880	15,880	—	—	—	—	—
Bonds retired.....	1,220,845	1,029,155	31,360	81,000	126,000	112,000	129,500	5,680
Partial defeasances.....	1,453,325	1,353,400	—	114,000	297,000	306,000	228,000	—
Bonds outstanding— 6/30/2006.....	<u>\$ 5,738,094</u>	<u>\$ 4,981,339</u>	<u>\$ 5,019</u>	<u>\$ —</u>	<u>\$ 27,000</u>	<u>\$ 32,000</u>	<u>\$ 92,500</u>	<u>\$ 20,225</u>
Bond Maturity As Follows:								
2006-07.....	343,263	288,588	1,558	—	27,000	16,000	18,500	2,135
2007-08.....	342,472	288,417	1,672	—	—	16,000	18,500	2,110
2008-09.....	339,194	285,104	1,789	—	—	—	18,500	2,080
2009-10.....	339,200	285,135	—	—	—	—	18,500	2,050
2010-11.....	339,360	285,330	—	—	—	—	18,500	2,025
2011-12.....	340,380	286,380	—	—	—	—	—	2,000
2012-13.....	342,305	288,465	—	—	—	—	—	1,980
2013-14.....	342,470	287,870	—	—	—	—	—	1,965
2014-15.....	341,715	287,115	—	—	—	—	—	1,950
2015-16.....	341,740	287,140	—	—	—	—	—	1,930
2016-17.....	339,395	284,795	—	—	—	—	—	—
2017-18.....	343,180	288,580	—	—	—	—	—	—
2018-19.....	344,265	289,665	—	—	—	—	—	—
2019-20.....	309,900	259,500	—	—	—	—	—	—
2020-21.....	229,500	229,500	—	—	—	—	—	—
2021-22.....	210,500	210,500	—	—	—	—	—	—
2022-23.....	203,455	203,455	—	—	—	—	—	—
2023-24.....	178,000	178,000	—	—	—	—	—	—
2024-25.....	98,400	98,400	—	—	—	—	—	—
2025-26.....	36,400	36,400	—	—	—	—	—	—
2026-27.....	16,500	16,500	—	—	—	—	—	—
2027-28.....	16,500	16,500	—	—	—	—	—	—
Total Bonds Outstanding.....	<u>\$ 5,738,094</u>	<u>\$ 4,981,339</u>	<u>\$ 5,019</u>	<u>\$ —</u>	<u>\$ 27,000</u>	<u>\$ 32,000</u>	<u>\$ 92,500</u>	<u>\$ 20,225</u>

[*] Capital
Appreciation
Bonds

Table 12

Payable from General Fund Revenues

Public Improvement Series 1999A 9-1-99 5.0-5.4%	Public Improvement Series 1999B 9-1-99 6.7-6.75%	Public Improvement Series 1999C 10-1-99 4.5-4.7%	Public Improvement Series 2000A 9-1-00 5.0-5.1%	Public Improvement Series 2001A 3-1-01 4.5-5.0%	Public Improvement Series 2002A 3-1-02 4.0-5.5%	Public Improvement Series 2002C 4-1-02 3.0-4.0%	Public Improvement Series 2002D 5-1-02 Variable to 18%	Public Improvement Series 2002E 5-1-02 Variable to 18%	Public Improvement Series 2002F 5-1-02 Variable to 18%
\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
—	—	—	—	—	—	—	—	—	—
—	—	—	295,000	100,000	—	—	55,000	—	—
—	—	—	—	—	—	—	—	—	—
177,400	20,000	2,600	5,000	30,000	204,400	10,600	—	—	—
—	—	—	—	250,000	—	—	33,750	88,750	88,750
—	—	—	—	—	—	—	—	—	—
177,400	20,000	2,600	300,000	380,000	204,400	10,600	88,750	88,750	88,750
—	—	—	—	—	—	—	—	—	—
36,000	17,100	2,250	60,000	80,000	56,400	8,600	—	—	—
116,400	—	—	180,000	112,000	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—
<u>\$ 25,000</u>	<u>\$ 2,900</u>	<u>\$ 350</u>	<u>\$ 60,000</u>	<u>\$ 188,000</u>	<u>\$ 148,000</u>	<u>\$ 2,000</u>	<u>\$ 88,750</u>	<u>\$ 88,750</u>	<u>\$ 88,750</u>
6,000	2,900	350	12,000	16,000	23,000	2,000	—	—	—
9,500	—	—	12,000	16,000	25,000	—	—	—	—
9,500	—	—	12,000	16,000	25,000	—	—	—	—
—	—	—	12,000	16,000	25,000	—	—	—	—
—	—	—	12,000	16,000	25,000	—	—	—	—
—	—	—	—	16,000	25,000	—	—	—	—
—	—	—	—	16,000	—	—	6,250	6,250	6,250
—	—	—	—	16,000	—	—	6,250	6,250	6,250
—	—	—	—	16,000	—	—	6,250	6,250	6,250
—	—	—	—	16,000	—	—	6,250	6,250	6,250
—	—	—	—	28,000	—	—	6,250	6,250	6,250
—	—	—	—	—	—	—	10,750	10,750	10,750
—	—	—	—	—	—	—	23,250	23,250	23,250
—	—	—	—	—	—	—	18,750	18,750	18,750
—	—	—	—	—	—	—	4,750	4,750	4,750
—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—	—	—
<u>\$ 25,000</u>	<u>\$ 2,900</u>	<u>\$ 350</u>	<u>\$ 60,000</u>	<u>\$ 188,000</u>	<u>\$ 148,000</u>	<u>\$ 2,000</u>	<u>\$ 88,750</u>	<u>\$ 88,750</u>	<u>\$ 88,750</u>

Continued

SCHEDULE OF GENERAL OBLIGATION BONDS PAYABLE (continued)

June 30, 2006

(Dollars in Thousands)

Payable from General Fund Revenues

	Public Improvement Series 2002G 5-1-02 Variable to 18%	Natural Gas Series 2002A 12-1-02 2.6 - 3.9%	Clean Water Series 2002A 12-1-02 2.25 - 5.0%	Refunding Series 2002A 12-1-02 2% - 5.25%	Refunding Series 2002B 12-12-02 Variable to 20%	Refunding Series 2002C 12-12-02 Variable to 20%	Refunding Series 2002D 12-12-02 Variable to 20%	Refunding Series 2002E 12-12-02 Variable to 20%
Bonds Authorized and Issued:								
Ch. 1048, 1987 session law	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Ch. 542, 1993 session law..	—	—	—	—	—	—	—	—
Ch. 631, 1995 session law..	—	—	—	—	—	—	—	—
General Statute Ch. 142....	—	—	—	56,480	100,000	100,000	100,000	100,000
Ch. 590, 1995 session law..	—	—	—	—	—	—	—	—
Ch. 132, 1998 session law..	—	50,000	18,800	—	—	—	—	—
Ch. 3, 2000 session law.....	88,750	—	—	—	—	—	—	—
2004 session law.....	—	—	—	—	—	—	—	—
Total bonds authorized and issued.....	88,750	50,000	18,800	56,480	100,000	100,000	100,000	100,000
Accretion.....	—	—	—	—	—	—	—	—
Bonds retired.....	—	30,000	620	16,955	—	—	—	—
Partial defeasances.....	—	—	—	—	—	—	—	—
Bonds outstanding— 6/30/2006.....	<u>\$ 88,750</u>	<u>\$ 20,000</u>	<u>\$ 18,180</u>	<u>\$ 39,525</u>	<u>\$ 100,000</u>	<u>\$ 100,000</u>	<u>\$ 100,000</u>	<u>\$ 100,000</u>
Bond Maturity As Follows:								
2006-07.....	—	10,000	210	6,075	—	—	—	—
2007-08.....	—	10,000	225	6,250	—	—	—	—
2008-09.....	—	—	235	6,795	—	—	—	—
2009-10.....	—	—	255	10,030	—	—	—	—
2010-11.....	—	—	270	10,375	—	—	—	—
2011-12.....	—	—	750	—	4,520	4,520	4,520	4,520
2012-13.....	6,250	—	1,815	—	10,920	10,920	10,920	10,920
2013-14.....	6,250	—	1,795	—	10,815	10,815	10,815	10,815
2014-15.....	6,250	—	1,775	—	10,700	10,700	10,700	10,700
2015-16.....	6,250	—	2,245	—	13,385	13,385	13,385	13,385
2016-17.....	6,250	—	510	—	3,520	3,520	3,520	3,520
2017-18.....	10,750	—	4,915	—	27,975	27,975	27,975	27,975
2018-19.....	23,250	—	3,180	—	18,165	18,165	18,165	18,165
2019-20.....	18,750	—	—	—	—	—	—	—
2020-21.....	4,750	—	—	—	—	—	—	—
2021-22.....	—	—	—	—	—	—	—	—
2022-23.....	—	—	—	—	—	—	—	—
2023-24.....	—	—	—	—	—	—	—	—
2024-25.....	—	—	—	—	—	—	—	—
2025-26.....	—	—	—	—	—	—	—	—
2026-27.....	—	—	—	—	—	—	—	—
2027-28.....	—	—	—	—	—	—	—	—
Total Bonds Outstanding....	<u>\$ 88,750</u>	<u>\$ 20,000</u>	<u>\$ 18,180</u>	<u>\$ 39,525</u>	<u>\$ 100,000</u>	<u>\$ 100,000</u>	<u>\$ 100,000</u>	<u>\$ 100,000</u>

Table 12

Payable from General Fund Revenues

Refunding Series 2002F 12-12-02 Variable to 20%	Clean Water Series 2003A 1-1-03 2.25% - 3.125%	Public Improvement Series 2003A 3-1-03 2.0% - 5.25%	Public Improvement Series 2003B 4-1-03 2.0-5.0%	Natural Gas Series 2003 4-1-03 1.5% - 3.5%	Clean Water Series 2003B 5-1-03 2.5% - 3.125%	Refunding Series 2003D 8-1-03 2.0%-4.75%	Refunding Series 2003E 8-1-03 4%-5%	Public Improvement Series 2004A 3-1-04 2%-5.25%	Natural Gas Series 2004A 3-1-04 2%-3.25%
\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
—	—	—	—	—	—	—	—	—	—
99,870	—	—	—	—	—	91,000	235,710	—	—
—	2,900	38,355	—	33,000	3,645	—	—	—	36,000
—	—	281,645	283,255	—	—	—	—	707,900	—
—	—	—	—	—	—	—	—	—	—
99,870	2,900	320,000	283,255	33,000	3,645	91,000	235,710	707,900	36,000
—	—	—	—	—	—	—	—	—	—
—	1,800	15,000	13,380	19,800	2,250	52,740	48,910	28,000	14,400
—	—	—	—	—	—	—	—	—	—
<u>\$ 99,870</u>	<u>\$ 1,100</u>	<u>\$ 305,000</u>	<u>\$ 269,875</u>	<u>\$ 13,200</u>	<u>\$ 1,395</u>	<u>\$ 38,260</u>	<u>\$ 186,800</u>	<u>\$ 679,900</u>	<u>\$ 21,600</u>
—	600	5,000	4,460	6,600	750	17,915	27,790	14,000	7,200
—	500	5,000	4,460	6,600	645	13,475	27,585	14,000	7,200
—	—	13,000	13,000	—	—	6,870	27,650	14,000	7,200
—	—	13,000	13,000	—	—	—	27,715	25,000	—
—	—	13,000	13,000	—	—	—	27,785	25,000	—
4,500	—	13,000	13,000	—	—	—	27,855	25,000	—
10,915	—	13,000	13,000	—	—	—	20,420	25,000	—
10,795	—	13,000	13,000	—	—	—	—	25,000	—
10,690	—	13,000	13,000	—	—	—	—	25,000	—
13,370	—	13,000	13,000	—	—	—	—	25,000	—
3,525	—	13,000	13,000	—	—	—	—	25,000	—
27,950	—	13,000	13,000	—	—	—	—	25,000	—
18,125	—	16,500	18,000	—	—	—	—	25,000	—
—	—	16,500	30,000	—	—	—	—	65,000	—
—	—	16,500	30,000	—	—	—	—	65,000	—
—	—	16,500	30,000	—	—	—	—	65,000	—
—	—	16,500	22,955	—	—	—	—	65,000	—
—	—	16,500	—	—	—	—	—	65,000	—
—	—	16,500	—	—	—	—	—	62,900	—
—	—	16,500	—	—	—	—	—	—	—
—	—	16,500	—	—	—	—	—	—	—
—	—	16,500	—	—	—	—	—	—	—
<u>\$ 99,870</u>	<u>\$ 1,100</u>	<u>\$ 305,000</u>	<u>\$ 269,875</u>	<u>\$ 13,200</u>	<u>\$ 1,395</u>	<u>\$ 38,260</u>	<u>\$ 186,800</u>	<u>\$ 679,900</u>	<u>\$ 21,600</u>

Continued

SCHEDULE OF GENERAL OBLIGATION BONDS PAYABLE (continued)

June 30, 2006

(Dollars in Thousands)

Payable from General Fund Revenues

	Clean Water Series 2004A 3-29-04 2%-3.25%	Clean Water Refunding Series 2004 9-29-04 3%-5.5%	Capital Improvement Refunding Series 2004 9-29-04 4%-5.5%	Public School Refunding Series 2004 9-29-04 5%	Public Improvement Refunding Series 2004 9-29-04 3%-5.5%	Public Improvement Series 2005A 1-12-05 4%-5.5%	Natural Gas 2005 1-12-05 3%-4%	Refunding Series 2005A 1-12-05 3%-5%
Bonds Authorized and Issued:								
Ch. 1048, 1987 session law	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Ch. 542, 1993 session law..	—	—	—	—	—	—	—	—
Ch. 631, 1995 session law..	—	—	—	—	—	—	—	—
General Statute Ch. 142.....	—	—	—	—	—	—	—	—
Ch. 590, 1995 session law..	—	—	—	—	—	—	—	—
Ch. 132, 1998 session law..	15,255	—	—	—	—	—	—	—
Ch. 3, 2000 session law.....	—	—	—	—	—	—	—	—
2004 session law.....	—	11,900	59,275	155,245	57,470	705,500	16,000	106,895
Total bonds authorized and issued.....	15,255	11,900	59,275	155,245	57,470	705,500	16,000	106,895
Accretion.....	—	—	—	—	—	—	—	—
Bonds retired.....	6,200	3,265	1,435	—	230	21,800	3,200	45
Partial defeasances.....	—	—	—	—	—	—	—	—
Bonds outstanding— 6/30/2006.....	\$ 9,055	\$ 8,635	\$ 57,840	\$ 155,245	\$ 57,240	\$ 683,700	\$ 12,800	\$ 106,850
Bond Maturity As Follows:								
2006-07.....	3,100	2,910	11,725	—	65	21,800	3,200	45
2007-08.....	3,100	2,870	11,580	30,825	70	21,800	3,200	50
2008-09.....	2,855	2,855	11,545	31,260	70	21,800	3,200	50
2009-10.....	—	—	11,515	31,160	9,575	21,800	3,200	50
2010-11.....	—	—	11,475	31,055	9,555	25,000	—	50
2011-12.....	—	—	—	30,945	9,535	25,000	—	12,025
2012-13.....	—	—	—	—	9,510	25,000	—	11,935
2013-14.....	—	—	—	—	9,490	25,000	—	11,810
2014-15.....	—	—	—	—	9,370	25,000	—	11,680
2015-16.....	—	—	—	—	—	25,000	—	11,600
2016-17.....	—	—	—	—	—	25,000	—	47,555
2017-18.....	—	—	—	—	—	25,000	—	—
2018-19.....	—	—	—	—	—	25,000	—	—
2019-20.....	—	—	—	—	—	54,000	—	—
2020-21.....	—	—	—	—	—	80,000	—	—
2021-22.....	—	—	—	—	—	80,000	—	—
2022-23.....	—	—	—	—	—	80,000	—	—
2023-24.....	—	—	—	—	—	77,500	—	—
2024-25.....	—	—	—	—	—	—	—	—
2025-26.....	—	—	—	—	—	—	—	—
2026-27.....	—	—	—	—	—	—	—	—
2027-28.....	—	—	—	—	—	—	—	—
Total Bonds Outstanding....	\$ 9,055	\$ 8,635	\$ 57,840	\$ 155,245	\$ 57,240	\$ 683,700	\$ 12,800	\$ 106,850

Table 12

Payable from General Fund Revenues			Payable from Highway Trust Fund				
Refunding Series 2005B 6-29-05 5%	Clean Water Series 2006A 3-30-06 3.875%-5.5%	Higher Education Series 2006A 6-14-06 4.25%-5.25%	Total Highway Trust	Highway Series 1997A 11-1-97 4.5-5.0%	Highway Series 2003 12-1-03 3%-5%	Highway Refunding Series 2004 9-29-04 5.0-5.5%	Highway Series 2004 9-29-04 3%-5%
\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	—	—	—	—	—
—	—	—	650,000	250,000	400,000	—	—
—	70,000	—	—	—	—	—	—
—	—	300,000	—	—	—	—	—
470,510	—	—	398,370	—	—	98,370	300,000
470,510	70,000	300,000	\$ 1,048,370	250,000	400,000	98,370	300,000
—	—	—	—	—	—	—	—
3,235	—	—	191,690	133,400	36,000	2,290	20,000
—	—	—	99,925	99,925	—	—	—
<u>\$ 467,275</u>	<u>\$ 70,000</u>	<u>\$ 300,000</u>	<u>\$ 756,755</u>	<u>\$ 16,675</u>	<u>\$ 364,000</u>	<u>\$ 96,080</u>	<u>\$ 280,000</u>
—	2,700	15,000	54,875	16,675	18,000	—	20,000
—	3,200	15,000	54,055	—	18,000	16,055	20,000
19,650	3,200	15,000	54,090	—	18,000	16,090	20,000
27,085	3,200	15,000	54,065	—	18,000	16,065	20,000
27,040	3,200	15,000	54,030	—	18,000	16,030	20,000
45,490	3,200	15,000	54,000	—	18,000	16,000	20,000
53,010	3,200	15,000	53,840	—	18,000	15,840	20,000
73,555	3,200	15,000	54,600	—	34,600	—	20,000
73,650	3,200	15,000	54,600	—	34,600	—	20,000
69,255	3,200	15,000	54,600	—	34,600	—	20,000
71,925	3,200	15,000	54,600	—	34,600	—	20,000
6,615	3,200	15,000	54,600	—	34,600	—	20,000
—	3,200	15,000	54,600	—	34,600	—	20,000
—	4,000	15,000	50,400	—	30,400	—	20,000
—	4,000	15,000	—	—	—	—	—
—	4,000	15,000	—	—	—	—	—
—	4,000	15,000	—	—	—	—	—
—	4,000	15,000	—	—	—	—	—
—	4,000	15,000	—	—	—	—	—
—	4,900	15,000	—	—	—	—	—
—	—	—	—	—	—	—	—
<u>\$ 467,275</u>	<u>\$ 70,000</u>	<u>\$ 300,000</u>	<u>\$ 756,755</u>	<u>\$ 16,675</u>	<u>\$ 364,000</u>	<u>\$ 96,080</u>	<u>\$ 280,000</u>

Source: Compiled by the Department of State Treasurer.

SCHEDULE OF SPECIAL OBLIGATION DEBT

June 30, 2006

Table 13

(Dollars in Thousands)

	Lease Purchase Revenue Bonds				Certificates of Participation				
	Total Special Obligation Debt	Total Lease Purchase Revenue Bonds	NC	NC	Total Certificates of Participation	Certificates of Participation Series 2003A 4-1-03 2.0% - 5.25%	Correctional Facilities Project Series 2004A 2-1-04	Certificates of Participation Series 2004A 5-6-04	Certificates of Participation Series 2005A 6-9-05
			Correctional Facilities Lease Purchase Series 2003 7-15-03 2.0% - 5.25%	Facilities Projects Lease Purchase Series 2004 11-1-04 2.0% - 5.25%					
Bonds Authorized and Issued:									
Ch. 284, 2003 session law.....	\$ 502,360	\$ 218,405	\$ 218,405	\$ —	\$ 283,955	\$ —	\$ 158,955	\$ 125,000	\$ —
Ch. 143, 2000 session law.....	17,500	—	—	—	17,500	17,500	—	—	—
General Statute Ch. 148-37.2....	53,640	53,640	—	53,640	—	—	—	—	—
Ch. 179, 2004 session law.....	188,385	—	—	—	188,385	—	—	—	188,385
Total bonds authorized and issued.....	761,885	272,045	218,405	53,640	489,840	17,500	158,955	125,000	188,385
Bonds retired.....	52,780	17,000	15,000	2,000	35,780	1,375	15,895	12,000	6,510
Bonds outstanding— June 30, 2006.....	\$ 709,105	\$ 255,045	\$ 203,405	\$ 51,640	\$ 454,060	\$ 16,125	\$ 143,060	\$ 113,000	\$ 181,875
Bond Maturity As Follows:									
2006-07.....	31,420	10,000	8,000	2,000	21,420	665	7,950	6,000	6,805
2007-08.....	31,760	10,000	8,000	2,000	21,760	690	7,950	6,000	7,120
2008-09.....	32,110	10,000	8,000	2,000	22,110	720	7,950	6,000	7,440
2009-10.....	32,470	10,000	8,000	2,000	22,470	740	7,950	6,000	7,780
2010-11.....	32,880	10,000	8,000	2,000	22,880	765	7,950	6,000	8,165
2011-12.....	33,325	10,000	8,000	2,000	23,325	795	7,950	6,000	8,580
2012-13.....	33,780	10,000	8,000	2,000	23,780	825	7,950	6,000	9,005
2013-14.....	34,265	10,000	8,000	2,000	24,265	860	7,950	6,000	9,455
2014-15.....	34,780	10,000	8,000	2,000	24,780	905	7,950	6,000	9,925
2015-16.....	35,325	10,000	8,000	2,000	25,325	950	7,950	6,000	10,425
2016-17.....	34,540	8,650	8,000	650	25,890	1,000	7,945	6,000	10,945
2017-18.....	34,995	8,500	8,000	500	26,495	1,055	7,945	6,000	11,495
2018-19.....	35,120	8,000	8,000	—	27,120	1,110	7,945	6,000	12,065
2019-20.....	57,630	28,850	19,000	9,850	28,780	1,165	7,945	7,000	12,670
2020-21.....	50,175	24,000	19,000	5,000	26,175	1,230	7,945	7,000	10,000
2021-22.....	50,235	24,000	19,000	5,000	26,235	1,290	7,945	7,000	10,000
2022-23.....	50,305	24,000	19,000	5,000	26,305	1,360	7,945	7,000	10,000
2023-24.....	51,170	26,225	23,405	2,820	24,945	—	7,945	7,000	10,000
2024-25.....	12,820	2,820	—	2,820	10,000	—	—	—	10,000
Total Bonds Outstanding.....	\$ 709,105	\$ 255,045	\$ 203,405	\$ 51,640	\$ 454,060	\$ 16,125	\$ 143,060	\$ 113,000	\$ 181,875

Source: Compiled by the Department of State Treasurer.

PLEDGED REVENUE COVERAGE REVENUE BONDS

For the Fiscal Years 2002-2006
(Dollars in Thousands)

Table 14

	2006	2005	2004	2003	2002
Town of Butner					
Pledged Revenue-					
Sales and services.....	\$ 2,377	\$ 3,531	\$ 3,673	\$ 3,936	\$ 3,581
Rental lease earnings.....	5	3	8	-	-
Fees, licenses and fines.....	8	14	14	13	17
Miscellaneous revenue.....	147	156	106	243	407
Less: Operating expenses.....	(2,261)	(2,470)	(2,372)	(2,341)	(2,276)
Net available revenue.....	<u>\$ 276</u>	<u>\$ 1,234</u>	<u>\$ 1,429</u>	<u>\$ 1,851</u>	<u>\$ 1,729</u>
Debt service					
Principal.....	\$ 270	\$ 255	\$ 245	\$ 235	\$ 100
Interest.....	394	414	419	434	431
Coverage.....	.42	1.85	2.16	2.77	3.26
N.C. Housing Finance Agency					
Pledged Revenue-					
Interest on investments.....	\$ 23,718	\$ 17,659	\$ 17,357	\$ 14,687	\$ 13,315
Interest on mortgage loans.....	66,515	69,816	74,650	83,045	82,789
Net increase/decrease in fair value of investments.....	(2,372)	544	-	-	3,926
Other revenue.....	444	198	147	92	710
Less: Operating expenses.....	(4,640)	(4,996)	(4,678)	(4,739)	(5,165)
Net available revenue.....	<u>\$ 83,665</u>	<u>\$ 83,221</u>	<u>\$ 87,476</u>	<u>\$ 93,085</u>	<u>\$ 95,575</u>
Debt service					
Principal.....	\$ 175,670	\$ 27,967	\$ 24,245	\$ 21,465	\$ 15,762
Interest.....	70,059	63,242	69,622	74,408	77,487
Coverage.....	.34	.91	.93	.97	1.03
State Education Assistance Authority					
Pledged Revenue-					
Student loan principal collections.....	\$ 660,332	\$ 300,827	\$ 277,552	\$ 214,782	\$ 133,041
Interest earnings on loans.....	115,306	80,912	50,037	46,587	55,281
Investment earnings.....	15,174	4,157	2,686	2,450	3,121
Less: Operating expenses.....	(24,627)	(19,395)	(17,603)	(14,781)	(10,692)
Net available revenue.....	<u>\$ 766,185</u>	<u>\$ 366,501</u>	<u>\$ 312,672</u>	<u>\$ 249,038</u>	<u>\$ 180,751</u>
Debt service					
Principal.....	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000
Interest.....	60,912	25,212	17,736	23,351	36,385
Coverage.....	12.38	13.98	16.69	10.23	4.84
University of North Carolina System					
Pledged Revenue-					
Sales and services.....	\$ 570,509	\$ 531,673	\$ 513,867	\$ 479,714	\$ 466,789
Student tuition and fees.....	52,002	51,657	54,525	54,025	48,773
Patient services.....	1,210,356	1,131,038	1,057,614	928,153	949,442
Contracts and grants.....	120,513	113,049	104,373	98,371	85,045
State appropriations.....	44,510	39,334	37,788	37,771	39,092
Fees, licenses and fines.....	14,863	13,056	12,413	11,834	9,416
Rental lease earnings.....	21,182	18,802	17,781	17,470	16,150
Investment income.....	32,793	19,121	20,580	53,432	43,196
Other operating revenues.....	30,385	30,133	32,284	38,509	41,003
Non-operating revenues.....	37,274	39,558	35,688	46,521	39,569
Less: Operating expenses.....	(1,767,630)	(1,653,952)	(1,604,207)	(1,487,632)	(1,460,074)
Net available revenue.....	<u>\$ 366,757</u>	<u>\$ 333,469</u>	<u>\$ 282,706</u>	<u>\$ 278,168</u>	<u>\$ 278,401</u>
Debt service					
Principal.....	\$ 57,783	\$ 54,917	\$ 54,467	\$ 48,520	\$ 48,515
Interest.....	71,473	58,146	53,067	53,351	55,104
Coverage.....	2.84	2.95	2.63	2.73	2.69

Information prior to 2002 not available.

SCHEDULE OF DEMOGRAPHIC DATA

For the Years 1950, 1960, 1970, 1980, 1990, 1997-2006

Year	Population ^[1]				Per Capita Income ^[2]			Personal Income (millions) ^[3]	
	United States Population	U.S. Increase from Prior Period	North Carolina Population	N.C. Increase from Prior Period	United States	North Carolina	N.C. as a Percentage of U.S.	United States	North Carolina
2006	299,196,662 [F]	0.94%	8,827,384 [F]	1.66%	\$ 36,132 [G]	\$ 31,918 [G]	88.34%	\$ 10,810,574	\$ 281,752
2005	296,410,404 [D]	0.94%	8,683,242 [D]	1.66%	34,586 [E]	30,553 [E]	88.34%	10,251,650	265,299
2004	293,655,404 [D]	0.98%	8,541,221 [D]	1.59%	32,937 [E]	29,246 [E]	88.79%	9,672,128	249,797
2003	290,809,777 [D]	0.85%	8,407,248 [D]	1.05%	31,632 [E]	28,235 [E]	89.26%	9,198,895	237,379
2002	288,368,698 [D]	1.25%	8,320,146 [D]	1.64%	30,832 [E]	27,566 [E]	89.41%	8,890,984	229,353
2001	284,797,000 [D]	0.95%	8,186,268 [D]	1.70%	30,472 [E]	27,514 [E]	90.29%	8,678,334	225,237
2000	282,125,000 [D]	3.46%	8,049,313 [D]	5.25%	29,770 [E]	27,055 [E]	90.88%	8,398,861	217,774
1999	272,691,000 [B]	0.90%	7,647,934 [C]	1.35%	27,880 [E]	25,504 [E]	91.48%	7,602,625	195,053
1998	270,248,000 [B]	0.92%	7,545,735 [C]	1.58%	26,893 [E]	24,661 [E]	91.70%	7,267,779	186,085
1997	267,784,000 [B]	0.96%	7,428,579 [C]	1.70%	25,412 [E]	23,468 [E]	92.35%	6,804,927	174,334
1990	248,791,000 [A]	9.82%	6,632,448 [A]	12.79%	19,588	17,295	88.29%	4,873,318	114,708
1980	226,546,000 [A]	11.13%	5,880,095 [A]	15.65%	10,062	8,090	80.40%	2,279,506	47,570
1970	203,849,000 [A]	13.26%	5,084,411 [A]	11.59%	4,072	3,255	79.94%	830,073	16,550
1960	179,979,000 [A]	18.51%	4,556,155 [A]	12.17%	2,254	1,615	71.65%	405,673	7,358
1950	151,868,000 [A]		4,061,929 [A]		1,496	1,037	69.32%	227,195	4,212

[A] - U.S. Census count - April 1 (1950 - 1990)

[B] - U.S. Census estimates - July 1 (1991 - 2000)

[C] - N.C. Office of State Planning estimate - July 1, 1991 - 1999, based on April, 1990 census population of 6,628,637 and April, 2000 census population of 8,049,313

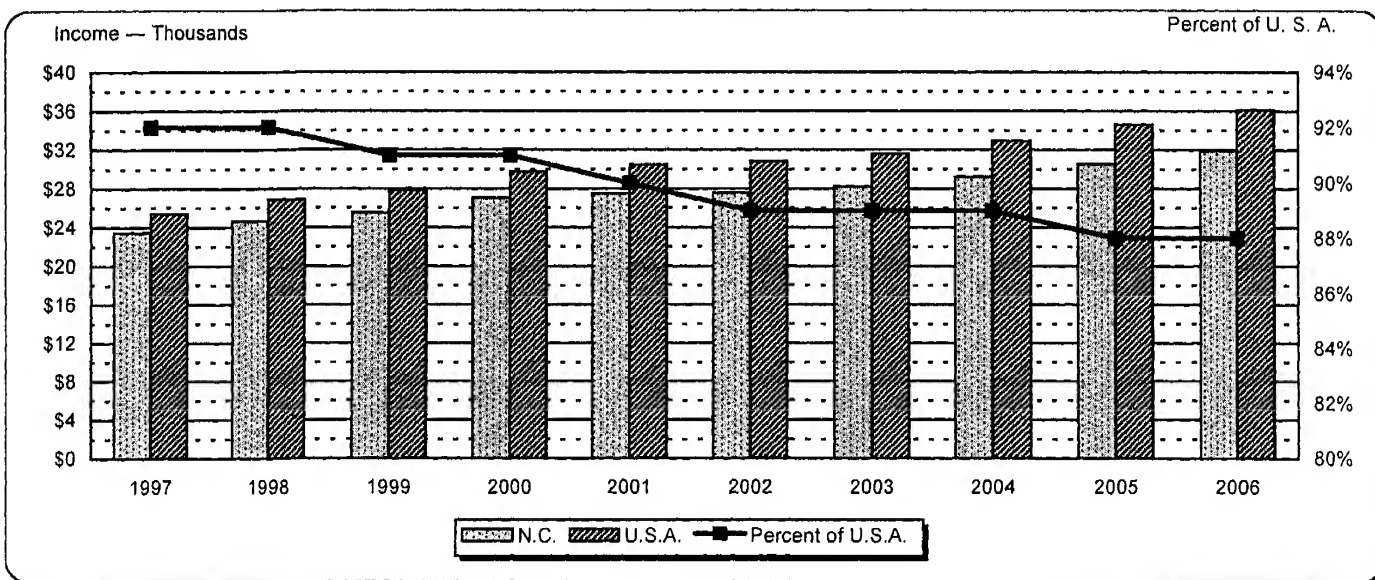
[D] - U.S. Census estimates based on 2000 census

[E] - Bureau of Economic Analysis estimate

[F] - Since the 2006 population estimates are not available, the Office of State Controller used the growth rate of the previous year to project the 2006 amounts.

[G] - Since the 2006 per capita income estimates are not available, the Office of State Controller used the U.S. Per Capita Income growth rate of the previous year to project the 2006 U.S. Per Capita Income and the previous year "N.C. as a Percentage of U.S." was used to project the "2006 Per Capita Income for North Carolina".

Per Capita Income North Carolina Compared to United States 1997 to 2006



Sources: [1] Population
 [2] Per Capita Income
 [3] Personal Income

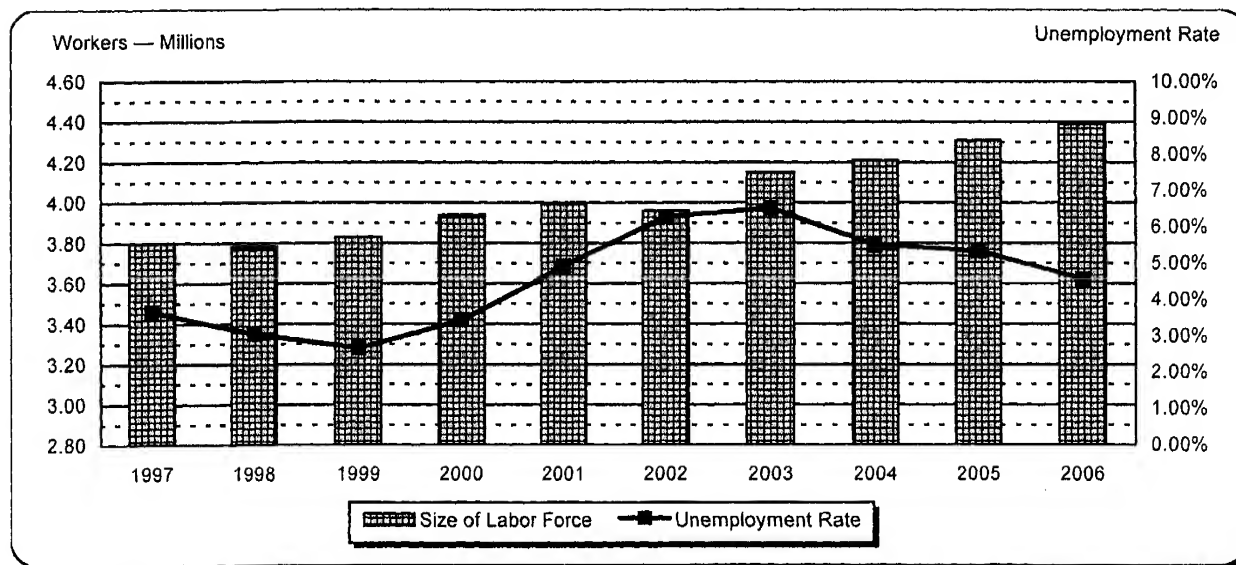
U.S. Department of Commerce, Bureau of the Census
 U.S. Department of Commerce, Bureau of Economic Analysis
 Calculated from sources 1 and 2

Table 15

North Carolina Civilian Labor Force Data [4]					North Carolina - Other Data	
Year	Total	Employed	Unemployed	Unemployed Percentage Rate	[5] Motor Vehicles Registered	[6] Residential Construction Authorized
2006	4,394,216	4,193,971	200,245	4.56%	8,407,473	54,626
2005	4,308,482	4,078,645	229,837	5.33%	7,925,587	50,488
2004	4,208,568	3,977,421	231,147	5.49%	7,701,410	46,735
2003	4,152,243	3,882,026	270,217	6.51%	7,624,272	38,137
2002	3,964,000	3,715,400	248,600	6.27%	7,498,181	40,763
2001	3,999,300	3,802,500	196,800	4.92%	7,344,437	23,555
2000	3,941,000	3,805,300	135,700	3.44%	7,112,610	77,351
1999	3,826,000	3,724,100	101,900	2.66%	6,911,814	105,117
1998	3,776,300	3,661,000	115,300	3.05%	6,428,104	103,432
1997	3,796,900	3,657,800	139,100	3.66%	6,392,269	93,609
1990	3,471,000	3,339,000	132,000	3.80%	5,600,050	30,471
1980	2,759,197	2,607,925	151,272	5.48%	5,094,814	6,730
1970	2,054,838	1,984,402	70,436	3.43%	3,218,292	N/A
1960	1,680,442	1,605,478	74,964	4.46%	1,907,988	N/A
1950	1,512,924	1,463,352	49,572	3.28%	1,171,228	N/A

N/A = Data not available.

**Civilian Labor Force Trends
With Unemployment Percentages
1997 to 2006**



Sources: [4] Seasonally Adjusted Labor Force Data - As of June 30
 [5] Motor Vehicle Registrations - For the Fiscal Year Ended June 30
 [6] Residential Housing Permits

N.C. Employment Security Commission
 N.C. Division of Motor Vehicles
 U.S. Department of Commerce, Bureau of the Census

PRINCIPAL EMPLOYERS

Fiscal Years 2001 and 2006

Table 16

Employer	2006			2001		
	Employees	Rank	Percentage of Total State Employment	Employees	Rank	Percentage of Total State Employment
State of North Carolina	170,000-174,999	1	4.11%	160,000-164,999	1	4.27%
Federal Government	60,000-64,999	2	1.48%	60,000-64,999	2	1.64%
Wal-Mart Stores, Inc.	45,000-49,999	3	1.13%	30,000-34,999	3	0.85%
Duke University	25,000-29,999	4	0.65%	20,000-24,999	5	0.59%
Food Lion LLC	25,000-29,999	5	0.65%	25,000-29,999	4	0.72%
Wachovia Bank, NA	25,000-29,999	6	0.65%	10,000-14,999	9	0.32%
Charlotte Board of Ed.	15,000-19,999	7	0.41%	15,000-19,999	7	0.45%
Wake Public Schools	15,000-19,999	8	0.41%	10,000-14,999	8	0.32%
Charlotte Hospital Authority	15,000-19,999	9	0.41%	10,000-14,999	10	0.32%
Bank of America, NA	10,000-14,999	10	0.29%	-	-	-
IBM Corporation	-	-	-	15,000-19,999	6	0.45%
Total	405,000-454,990		10.19%	355,000-404,990		9.93%

Notes: All figures are based on 1st quarter average. Percentage of total state employment is based on the midpoints in the ranges given. Information prior to 2001 is not available.

Source: North Carolina Employment Security Commission

TEACHERS AND STATE EMPLOYEES BY FUNCTION

For the Fiscal Years 2002-2006

Table 17

Functions	2006	2005	2004	2003	2002
General government.....	5,680	5,435	5,301	5,635	5,635
Primary and secondary education.....	156,463	152,746	147,798	143,428	140,103
Higher education:					
Universities.....	55,800	53,560	51,902	50,787	49,625
Community Colleges.....	15,610	15,764	15,277	14,582	13,959
Health and human services.....	20,766	20,665	20,366	18,545	18,816
Economic development.....	2,567	2,366	2,469	2,466	2,591
Environment and natural resources.....	4,616	4,493	4,341	4,337	4,750
Public safety, corrections and regulations.....	31,448	30,429	30,125	30,810	30,982
Transportation.....	14,007	14,379	14,218	14,438	14,378
Agriculture.....	1,377	1,339	1,343	1,275	1,295
Totals[1].....	<u>308,334</u>	<u>301,176</u>	<u>293,140</u>	<u>286,303</u>	<u>282,134</u>

[1] Prior years 2002-2005 have been restated to include all teachers and state employees.

Source: North Carolina Office of State Budget and Management
 Counts for fiscal year end 2006 are projected from prior year data.
 Information prior to 2002 not available.

OPERATING INDICATORS BY FUNCTION

For the Fiscal Years 2002-2006

	2006	2005	2004	2003	2002
General Government					
Department of Revenue					
Number of tax returns filed electronically.....	2,487,716	1,922,459	1,666,765	1,436,218	1,239,844
Number of tax returns processed.....	10,437,669	9,947,817	9,725,620	9,778,591	9,658,531
Number of individual refunds direct deposited.....	809,473	673,976	564,200	446,217	na
Number of individual refunds processed.....	2,834,960	2,732,523	2,658,709	2,654,339	2,595,070
Number of pieces of incoming mail.....	7,986,688	8,334,624	8,122,589	8,222,560	9,061,094
Number of pieces of outgoing mail.....	9,206,342	8,687,346	8,922,981	10,098,087	9,332,605
Department of Administration					
Construction projects administered.....	71	226	181	213	205
Construction value excluding design fee (thousands).....	\$ 73,006	\$ 873,713	\$ 486,287	\$ 522,060	\$ 359,381
Cultural Resources					
Visitation to historical sites and museums.....	2,068,910	2,356,046	2,465,484	2,234,241	1,326,603
Primary and Secondary Education					
Public School(K-12)					
Public school enrollment.....	1,368,607	1,346,681	1,325,344	1,303,777	1,285,729
Total high school graduates.....	72,580	74,691	71,853	69,568	65,681
Graduate intention to pursue further education.....	87.09%	84.64%	83.26%	83.63%	83.13%
Higher Education					
Community Colleges					
Number of students (annualized FTE).....	190,644	194,235	192,693	185,490	176,743
Number of certificates and degrees awarded.....	28,983	29,600	27,050	23,645	22,853
Universities					
Number of regular term students (FTE).....	176,619	158,398	152,224	171,409	141,272
Number of certificates and degrees awarded.....	37,348	37,569	36,689	34,580	32,644
Health and Human Services					
Department of Health and Human Services					
Medicaid recipients (a).....	1,673,510	1,545,366	1,541,450	na	na
Food stamp recipients.....	838,064	818,141	791,241	na	na
Clients served by mental health facilities.....	18,678	18,894	16,353	na	na
Clients served by developmental disabilities facilities.....	2,114	2,172	2,189	na	na
Clients served by substance abuse facilities.....	3,854	3,633	3,572	na	na
Children served through subsidized child care.....	149,946	155,339	156,534	na	na
Participation in Special Supplemental Nutrition Program.....	230,140	224,670	218,345	na	na
Clients served through Work First.....	69,885	39,426	42,177	na	na
NC Health Choice annual enrollment.....	199,160	169,491	na	na	na
Economic Development					
Department of Commerce					
Jobs generated company recruitment/expansion.....	20,293	18,246	15,393	9,531	13,459
Capital investment (thousands).....	\$ 3,024,914	\$ 2,982,292	\$ 1,863,213	\$ 1,127,466	\$ 2,690,123
Employment Security Commission					
Total employed.....	4,193,971	4,087,359	3,977,421	3,882,026	3,715,400
Percentage of unemployment.....	4.56%	5.38%	5.49%	6.51%	6.27%

Table 18

	2006	2005	2004	2003	2002
Environment and Natural Resources					
Department of Environment and Natural Resources					
Public drinking water systems in compliance.....	94%	93%	94%	93%	95%
Visitation to Museum of Natural Sciences.....	622,915	556,422	913,751	518,132	517,058
Visitation to NC Zoo.....	682,977	705,030	676,956	576,093	671,619
Wildlife Resources Commission					
Hunting licenses sold.....	204,451	107,242	107,572	109,511	114,304
Fishing licenses sold.....	451,412	331,688	329,314	302,581	343,045
Vessels registered.....	363,641	354,096	361,134	354,863	358,007
Public Safety and Correction					
Department of Correction					
Incarcerated offenders.....	37,121	36,481	34,990	33,378	32,856
Supervised offenders.....	116,513	117,611	117,196	118,285	117,374
Administrative Office of the Courts					
Cases disposed as a % of cases filed-Superior Court.....	93.80%	95.52%	96.27%	93.40%	94.28%
Cases disposed as a % of cases filed-District Court.....	98.10%	97.56%	95.92%	97.46%	96.76%
Agriculture					
Department of Agriculture and Consumer Services					
Motor fuel dispensers tested (b).....	109,699	95,735	103,026	80,390	85,353
Rejection rate.....	10.77%	8.87%	7.22%	9.25%	9.99%
Retail scales tested (c).....	24,896	27,678	23,335	29,021	24,021
Rejection rate.....	8.28%	9.09%	8.70%	7.54%	7.07%

Notes:

- (a) A significant portion of the increase in Medicaid recipients from 2005 to 2006 is the result of legislation moving children formerly covered under State Child Health Insurance Program to Medicaid for 2006. This change resulted in minimal additional cost to the Medicaid program.
- (b) Governed by Gasoline and Oil Inspection Law (G.S. 119)
- (c) Governed by North Carolina Weights and Measures Act (G.S. 81A)

Information prior to 2002 not available.

CAPITAL ASSET STATISTICS BY FUNCTION

For the Fiscal Years 2002-2006

	2006	2005	2004	2003	2002
Primary Government					
General Government					
Department of Administration					
Buildings.....	136	134	132	132	132
Parking lots.....	49	17	18	20	n/a
Parking spaces.....	8,156	7,879	7,961	8,249	n/a
Motor Fleet vehicles	10,785	16,145	14,592	13,190	13,098
Health and Human Services					
Mental Health Institutions.....	12	12	12	12	12
Number of certified beds.....	5,009	4,885	5,083	5,220	5,390
Environment and Natural Resources					
Department of Environment and Natural Resources					
Number of state park lands.....	32	32	30	30	30
Acres of state park lands.....	222,251	182,251	176,146	173,833	172,763
Number of state recreation areas.....	4	4	4	4	4
Acres of state recreation areas.....	12,240	12,240	12,240	12,240	12,238
Number of state natural areas.....	14	17	17	16	14
Acres of state natural areas.....	32,930	30,513	30,323	28,999	27,643
Number of state lakes.....	7	7	7	7	7
Acres of state lakes.....	29,135	29,135	29,135	29,135	29,135
Zoo animals (a).....	1,942	2,024	2,643	2,411	2,059
Vehicles	1,723	1,618	1,574	1,471	1,403
Boats/Trailers.....	366	327	308	278	254
Aircraft.....	30	40	40	39	39
Scientific equipment.....	4,454	3,979	3,572	3,366	3,155
Wildlife Resources Commission					
Number of Game Lands.....	38	37	35	34	33
Acres of Game Lands.....	341,351	317,467	325,794	288,238	294,471
Public Safety and Correction					
Department of Correction					
Close security prisons.....	13	13	16	13	13
Medium security prisons.....	26	26	24	24	24
Minimum security prisons.....	39	37	36	36	39
Vehicles:					
Passenger/Cargo vans.....	99	85	69	67	61
Inmate transfer vans/buses.....	481	418	398	391	386
Inmate workcrew vans/buses.....	301	380	394	349	351
Pickup trucks.....	287	275	325	248	277
Roving patrol pickups.....	84	78	77	64	55
One tone maintenance trucks.....	105	92	98	99	112
Specialty/Other trucks (b).....	103	113	108	103	94
Enterprise Vehicles:					
Passenger/Cargo vans.....	23	24	31	29	30
Inmate workcrew buses.....	21	22	21	25	28
Pickup trucks.....	47	51	41	45	41
One ton maintenance trucks.....	18	16	21	18	21
Other/Specialty trucks.....	93	95	86	91	88

Table 19

	2006	2005	2004	2003	2002
Department of Crime Control and Public Safety					
Vehicles:					
<i>Alcohol Law Enforcement</i>					
Cars/SUV's.....	156	134	154	124	127
<i>State Highway Patrol</i>					
Cars.....	2,417	2,283	2,312	1,799	1,846
Trucks/Vans.....	114	59	63	65	99
Motorcycles.....	9	(c)	(c)	(c)	(c)
Air craft:					
<i>State Highway Patrol</i>					
Helicopters.....	13	14	11	11	11
Transportation					
Department of Transportation					
Pavement in lane-miles:					
Primary subsystem.....	(d)	14,805	14,760	14,705	14,670
Secondary subsystem.....	(d)	64,204	64,085	63,910	63,820
Bridges:					
Number of bridges.....	13,007	12,961	12,916	12,839	12,806
Number of culverts.....	4,912	4,879	4,761	4,683	4,620
Vehicles.....	5,823	6,347	7,466	7,015	6,182
Heavy Equipment.....	3,119	3,359	3,788	3,741	3,448
Component Units					
Higher Education					
Community Colleges					
Buildings.....	1,014	1,025	1,064	1,054	1,043
Universities					
Academic/Administrative buildings.....	930	918	893	873	866
Dormitories/Auxiliary buildings.....	583	565	537	524	510
Medical (e).....	51	51	51	51	51
University system hospitals					
Administration.....	3	3	3	3	2
Clinical.....	5	5	5	5	5
Facility services.....	1	1	1	1	1
Hospital.....	1	1	1	1	1

Notes:

- (a) 500-600 fish were lost due to aquarium malfunction in 2005.
- (b) Includes boom trucks, cranes, flat beds, rollbacks, yard trucks, dump trucks, semi-trucks, etc.
- (c) Prior year data from the source was not available.
- (d) Recent data from the source was not available, as of the date of publication.
- (e) East Carolina Teaching Hospital

Information prior to 2002 is not available.

REQUIRED SUPPLEMENTARY INFORMATION
TEN-YEAR CLAIMS DEVELOPMENT INFORMATION
PUBLIC SCHOOL INSURANCE FUND
For the Fiscal Years Ended June 30, 1997-2006

The following table illustrates how earned revenues (net of reinsurance) and investment income of the Public School Insurance Fund (the Fund) compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the Fund for the last ten fiscal years ended June 30. The rows of the table are defined as follows:

- (1) Total of each fiscal year's earned contribution revenues, investment revenues, contribution revenues ceded to excess insurers or reinsurers, and amount of reported revenues net of excess insurance or reinsurance.
- (2) Each fiscal year's other operating costs of the Fund, including overhead and claims expense not allocable to individual claims.
- (3) The Fund's incurred claims (both paid and accrued) as originally reported at the end of the first year in which the event that triggered coverage under the contract occurred (before the effect of loss assumed by excess insurers or reinsurers), the loss assumed by excess insurers or reinsurers, and total net amount of incurred claims and allocated claim adjustment expenses.
- (4) Cumulative amounts paid as of the end of successive years for each policy year.
- (5) The reestimated amount for loss assumed by excess insurers or reinsurers as of the end of the current year.
- (6) The reestimated net incurred claims and expenses based on the information available as of the end of the year. This annual reestimation results from new information received on known claims, reevaluation of existing information on known claims, as well as emergence of new claims not previously known.
- (7) Comparison of the latest reestimated net incurred claims amount to the amount originally established (line 3) and indication of whether this latest estimate of claims cost is greater or less than originally thought.

REQUIRED SUPPLEMENTARY INFORMATION
TEN-YEAR CLAIMS DEVELOPMENT INFORMATION
PUBLIC SCHOOL INSURANCE FUND
For the Fiscal Years Ended June 30, 1997-2006

Table 20

As data for individual policy years mature, the correlation between original estimated and reestimated amounts is commonly used to evaluate the accuracy of incurred claims currently recognized in less mature policy years. The columns in the table present data for successive policy years. Amounts are expressed in thousands.

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
1) Required contribution and investment revenue:										
Earned.....	7,099	8,354	6,343	6,687	8,136	9,599	12,255	10,826	16,219	12,538
Ceded.....	2,298	2,041	1,683	1,727	2,453	2,839	3,396	3,121	2,380	2,489
Net earned.....	4,801	6,313	4,660	4,960	5,683	6,760	8,859	7,705	13,839	10,049
2) Unallocated expenses	2,941	2,706	2,398	2,541	3,214	3,597	3,953	3,689	2,951	3,092
3) Estimated claims and expenses, end of policy year:										
Incurred.....	14,351	8,496	8,615	21,141	6,449	4,846	2,690	12,586	2,093	3,096
Ceded.....	6,862	700	357	—	—	—	—	—	—	—
Net incurred.....	7,489	7,796	8,258	21,141	6,449	4,846	2,690	12,586	2,093	3,096
4) Paid (cumulative) as of:										
End of policy year.....	9,595	2,044	4,077	13,158	422	392	1,921	10,381	3,129	3,130
One year later.....	13,129	4,193	5,931	15,818	2,475	640	2,765	12,788	3,536	—
Two years later.....	13,803	4,297	6,108	17,368	2,475	640	3,219	13,120	—	—
Three years later.....	13,810	4,324	6,388	17,368	2,475	640	3,681	—	—	—
Four years later.....	13,822	4,324	6,388	17,368	2,475	640	—	—	—	—
Five years later.....	13,822	4,324	6,388	17,368	2,475	—	—	—	—	—
Six years later.....	13,822	4,324	6,388	17,368	—	—	—	—	—	—
Seven years later.....	13,822	4,324	6,388	—	—	—	—	—	—	—
Eight years later.....	13,822	4,324	—	—	—	—	—	—	—	—
Nine years later.....	13,822	—	—	—	—	—	—	—	—	—
5) Reestimated ceded claims and expenses.....	6,862	700	357	—	—	—	—	—	—	—
6) Reestimated net incurred claims and expenses:										
End of policy year.....	7,489	7,796	8,258	21,141	6,449	4,846	2,690	12,586	2,093	3,096
One year later.....	6,771	3,724	6,740	17,240	2,475	4,846	3,543	12,911	2,093	—
Two years later.....	7,023	3,735	6,161	17,368	2,475	4,846	3,947	12,911	—	—
Three years later.....	6,976	3,640	6,031	17,368	2,475	4,846	3,947	—	—	—
Four years later.....	6,960	3,624	6,031	17,368	2,475	4,846	—	—	—	—
Five years later.....	6,960	3,624	6,031	17,368	2,475	—	—	—	—	—
Six years later.....	6,960	3,624	6,031	17,368	—	—	—	—	—	—
Seven years later.....	6,960	3,624	6,031	—	—	—	—	—	—	—
Eight years later.....	6,960	3,624	—	—	—	—	—	—	—	—
Nine years later.....	6,960	—	—	—	—	—	—	—	—	—
7) Increase (decrease) in estimated net incurred claims and expenses from end of policy year.....	(529)	(4,172)	(2,227)	(3,773)	(3,974)	—	1,257	325	—	—



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